CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.2: AUDIT PRACTICE AND ASSURANCE SERVICES

DATE: FRIDAY, 01 DECEMBER 2023

MARKING GUIDE AND MODEL ANSWERS

SECTION A

Question One: Connected Rwanda Ltd

Marking Guide to Question One: Connected Rwanda Ltd

Q1 (a): how you would obtain a reasonable comfort that you understand Connected Rwanda Ltd in line with ISA 315 for the audit of its financial statements for the year ended 30 September 2023

Award up to 2 marks for every well explained point specific to Connected Rwanda with a maximum of 10 marks. (1 mark for identification and 1 mark for explanation).

Q1.b Evaluate the business risks that should be considered in planning the audit of Connected Rwanda's financial statements for the year ended 30 September 2023.

Award up to 2 marks for every well explained point specific to Connected Rwanda with a maximum of 14 marks. (1 mark for identification and 1 mark for explanation).

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

Q1.c Evaluate the principal risks of material misstatements to be considered in planning of the final audit of financial statements of Connected Rwanda Ltd.

Award up to 3 marks for every well explained point specific to Connected Rwanda with a maximum of 16 marks. (1 mark for identification and 2 marks for explanation).

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

Q1. d) Your engagement partner has requested you to use analytical procedures on financial and non-financial data to ensure that they help you to identify risks areas and anomalies as you conduct a risk-based audit. Explain how analytical procedures would assist you in this process?

Award up to 2 marks for every well explained point with a maximum of 10 marks (1 mark for identification and 1 mark for explanation).

Total marks for Question One **50 Marks**

Model Answer to Question One: Connected Rwanda Ltd

Part (a): How you would obtain a reasonable comfort that you understand Connected Rwanda Ltd in line with ISA 315 for the audit of its financial statements for the year ended 30 September 2023?

1) Understanding of the entity

Inquiries of Connected Rwanda Ltd.'s management, and of others within the entity who in your judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error.

- Performing analytical procedures on the company's statement of financial position and statement of comprehensive income. This helps the auditor understand the causes in movement of numbers and what Connected Rwanda Ltd dealt in which caused significant movements in numbers hence identifying risky financial statements line items to give much focus to.

- **Schedule a meeting with outgoing auditor of Connected Rwanda Ltd**

It is vital for you as a new hired auditor to meet the auditor that you have replaced with the client's permission to both auditors, to help with the review of the predecessor auditor's working papers and understand the reasonableness of opening balances that they (PFA Ltd) inherit. The discussion with the outgoing auditor gives you an advantage of understanding which issues they faced in the previous audits and how the management has been responding to them, this benefits the new auditor by planning accordingly.

- **Review of previous year management letter from the outgoing auditor and financial report of Connected Rwanda Ltd.**

The management letter outlines the key audit issues that come to the attention of the auditor, how they approached them and the management's responses to them. This ensures that a follow-up is made on the reported issues to make sure that they were subsequently resolved and if not, understand what the management plans for them. Additionally, it is important to understand how they impact the current year's audit. In this line, you will understand how there were inappropriate privileged access restrictions on some of the staff dealing with mobile money services as reported in the previous auditor's report.

- **Review of board audit committee packs/minutes, minutes of shareholders, directors and other oversight bodies**

The audit committee's role is one of an oversight and monitoring of how the business is run, and in carrying out this responsibility, the committee may rely on management, the independent auditor, and any advisers the committee might engage, provided its reliance is reasonable. The review of its minutes will help the auditor identify potential matters of significance to the audit that might impose a risk on the presentation of financial statements, and it facilitates the auditor to design audit procedures to tackle them. Though it was not shared whether Connected

Rwanda has internal audit team, the service may be outsourced as the company hires more staff enquiries can also be made about how effective the internal audit function is.

- **Internet search and review of information on the company's website**

With use of internet, it is easier than even to fetch more information about an entity, a country, or any other thing it is paramount for an auditor to read Connected Rwanda Ltd's website to understand the entity's business, governance, the entity's managerial structure, products etc. There are also other websites or internet platforms which might provide information about the audit client (Connected Rwanda Ltd) and the internet search by the auditor can expose him to such information useful to his duties.

2) Understanding of the regulatory environment

Since Connected Rwanda Ltd is a telecommunication company operating in Rwandan, it is a requirement that the auditor reads about the regulatory framework/guideline issued by the Rwanda Utilities Regulatory Agency (RURA) and National Bank of Rwanda and Rwanda Revenue Authority. Since the industry is highly regulated, this will enable the auditor to understand which regulatory requirements in as far as tax and regulatory reporting bind the client (Connected Rwanda).

- **Read international reports and publications such as World bank and IMF reports**.

These reports will mainly provide insights on which economies are in recession, decline, depression or so and since these macro-economic factors have an indirect impact on Connected Rwanda, the auditor needs to understand these factors and how they are incorporated in the business performance review of the company.

- Analyzing competition that Connected Rwanda faces by reading RURA reports. In case the competition is stiff, and it is affecting the company's performance, the auditor should advise the management on the way forward. The reports may provide insights into the number of subscribers per telecommunication company, data usage etc. The company can utilize this data and forge a way to position itself better in the market.

- Review of Government policies currently affecting the conduct of the entity's business, such as monetary, including foreign exchange controls, fiscal, financial incentives (for example, government aid programs), and tariffs or trade restrictions policies.

Part (b): Business risks faced by Connected Rwanda Ltd to be considered in the final audit

Dependance on key IT infrastructure not operated and nor based in Rwanda

Connected Rwanda uses CompX and QantX to manage charges on airtime and internet respectively. Both key infrastructure in the business is neither hosted nor operated in the country; therefore, management does not have any control over those systems. Though the local management may be involved in the setting of the charge-out rates, there is a need to conduct a monitoring and follow up to ensure that rates charged to clients are accurate. Worse off, there are no local competent personnel to monitor the system to ensure that it is working well or to assist clients in case of any complaints.

In case the advertised rates are not currently charged by Connect Rwanda Ltd, this can lead to lawsuits and sanctions from the regulator which will have a bad reputation leading to a loss of the revenue if the customers lose trust in the company's products (or may result in a drain in the cash flows if the lawsuits and sanctions from the regulator lead to penalties that have to be settled.

Unaddressed complaints from customers over alleged overcharging on airtime and internet data.

The regulator is investigating this matter and it is obvious that Connected Rwanda Ltd will not be in a position to provide satisfactory responses. There is a likelihood to incur heavy sanctions from the regulator and lawsuits from customers. In case this transpires, it will worsen off the financial position of Connected Rwanda Ltd. If the situation remains the same, the company will also face reputational risks.

Multiple licensing for offering 4G internet

Multiple licensing of 4G internet operated may have either a positive or a negative outcome. In case Connected Rwanda Ltd is in a position to offer own 4G internet at a cheap cost, this would render it more competitive; however, the company could also lose the market position in case other competitors are ahead in adopting cheaper 4G internet when Connected Rwanda is lagging behind.

Since voice and internet can be offered using the same account (Sim Card), in case Connected Rwanda Ltd.'s 4G internet becomes more expensive than the prices charged by the competitors, clients may switch to competitors for all the packages including voice, internet and mobile money products. Remember that big clients with high end smartphones can only put one sim card in their phones. As a consequence, Connected Rwanda will lose revenue for some or all the packages if the customers switch to the competitors which also impact aversely on its profits.

Fraud over mobile money transfers and split with other business

This is a sensitive business line and therefore, there are expectation by the customers and regulators to ensure that the platform safe and secure all the time. Deposits from customers amount is expected to be material. The company processed FRW 20 Billion worth of transactions during the year under review alone. Plans for ensuring that the system is secured should be reviewed, including public education about password sharing.

The split between mobile money and the core business has a major impact including the potential revenue loss and increase of costs, considering that there will be two independent businesses. Considering the revenue share, it is worth reviewing whether voice and internet will be enough to keep the business afloat. The plans to recoup the investment made within the next 15 years and to be profitable after 5 years should also be revisited.

Also, clarity should be sought whether the mobile money business line will be a subsidiary of Connected Rwanda or Connected International – as this will have an impact on the survival of connected Rwanda.

Resignation of the managing director

There are leadership issues at Connected Rwanda that may be affecting the performance of the company. The Managing Director having resigned as a result of unrealistic cost-cutting goals set by the board of directors and a shortage of staff could lead to the risks of weak control environment. Excessive cost cutting could also affect the customer care that the service company offers to its clients.

The lack of an adequate number of competent staff renders the company unable to perform to its potential and hinders growth. There is a chance that this leaves a room of opportunities that competitors are taking advantage of at the expense of Connected Rwanda.

Expansion: Connect business to Burundi

It was noted that Connected Rwanda is in advanced discussions with Connected International to open a subsidiary in Burundi, whole owned by Connected Rwanda Ltd. Connected Rwanda has accumulated losses of FRW 279 Bn and long-term borrowings of FRW 49 Bn. This shows that the company is not yet financially stable to create and sustain another similar company in a new country like Burundi when huge investments are required to be made.

The senior management may also be distracted to properly supervise Connected Rwanda business with their attention drawn to opening Connected Burundi, which may lead to misappropriation of company’s assets.

Management assumptions would need to be scrutinized to see whether those plans are feasible or else, this may render Connected Rwanda to have going concern issues or going bankrupt.

Tower management contract

Although the management of towers has been contracted to Akeza Technics Ltd whereby, they service all towers used by Connected Rwanda Ltd with an annual fee is FRW 5 billion. There is no proper follow up from the side of Connected Rwanda to ensure that services are being provided as agreed in the contract. The fact that the contractor's report is being shared with the person in charge of logistics, who does not evidently possess the required skills and knowledge to challenge and confirm that the works were done as reported. As a result, the faults and damage to towers could not be identified on time and lead to an impairment of FRW 6 billion.

Part (c): principal risks of material misstatements to be considered in planning of the final audit of financial statements of Connected Rwanda Ltd

Recognition of loaded airtime and internet bundles as revenue instantly

Revenue from airtime and internet bundles should be recognized only after they have been consumed by customers. The current practice of recognizing the loaded amount is contrary to IFRS 15 standard which requires to recognise revenue when the performance obligation is satisfied; meaning after the customer has used calls and data. This will impact the reported revenue of FRW 41,800 million and also the reported net profit, and the accumulated losses.

Any adjustment to be made will affect those 3 streams of revenue negatively as revenue could be overstated and the deferred income (liabilities) understated.

This would require therefore, passing an adjustment of financial statements or modification of audit opinion in case the balance is material.

High operating expenses

Operating expenses are 96% of the revenue in 2023 and about 103% in 2022. Though Connected Rwanda has been operating for the last 4 years, this is significant and can cause going concern risks should the company continue to incur high operating costs. During the audit, a detailed account of the expenses should be scrutinized including checking whether there are no mis-postings, for example assets being recognized as expenses. Also, a comparison of the industry should be made to ensure the reasonableness.

Disclosure of going concern risks

The accounting standard requires the entity to prepare its financial statements on a going concern basis and the entity should disclose any material uncertainties regarding going concern in the notes to the financial statements. The risk is that Connected Rwanda Ltd may not have either disclosed or could have inadequately disclosed any material uncertainties for example the fact that for four years since its incorporation it has been incurring significant operating expenses compared to its revenue and also considering that it has been running with accumulated losses for the past two years. In the current year, the operating expenses are 96% of the revenue in 2023 while this was about 103% in 2022 and this is material. Lack of adequate disclosures of the material uncertainties regarding the going concern results in inadequate disclosure and hence a disclosure risk.

Impairment provision on towers

In accordance with IAS 36 "Impairment of assets, where an asset is assessed to be impaired, the impairment loss should be accurately measured as the lower of the carrying amount and the recoverable amount of the asset where the recoverable amount is the higher of value in use and the fair value less costs of disposal.

Despite having a management contract with Akeza Technics Ltd to service-Connected Rwanda towers, it was found that through an assessment that there were faults and damages of certain towers around the country that swept away FRW 6 billion of value/book value of towers. This represents around 9% of the book value, therefore – material.

The risk is that Connected Rwanda Ltd may not have appropriately computed the correct impairment loss if for example the methodologies and assumptions applied by Akeza Technics Ltd have not been competently reviewed by technical personnel since the report from Akeza is only submitted to the Logistics staff of Connected Rwanda Ltd who may not have the competence to evaluate the assumptions used in the calculation. if the impairment loss is incorrectly calculated then, the expenses are understated and the towers (assets) are overstated if a low amount of the impairment loss was measured and recognized.

This shows that there is poor internal control system around this as the contractor's report is submitted to the staff in charge of logistics, who submits it to finance for payment processing without consulting any competent professional within or outside of the company.

Relaxed credit policy.

IFRS 9 requires you to recognize the impairment of financial assets in the amount of expected credit loss (ECL). Connected Rwanda has implemented a relaxed credit policy for corporate clients with a credit period extended from 30 days to 90 days in an aim of increasing revenue. As much as this may have some impact on the company's sales, there is a high risk of failure to recover receivables; which would lead to high provision of doubtful debt and ultimately high expected credit loss to be recognized in the financial statements. Connected may have recognized the provision for doubtful debts using incorrect Exposure at default (EAD), Probability of default (PD) and Loss given default (LGD) while applying IFRS 9.

Creation of the Burundi subsidiary owned by Connected Rwanda

Creation of the subsidiary in Burundi is a non-adjusting event according to IAS 10: events after the reporting period. However, this should be disclosed in the notes to the financial statements of Connected Rwanda as it is material. Failure to disclose this would be misleading users of Connected Rwanda's financial statements.

Borrowings and finance costs

The debt ratio stands at 72% with a large portion acquired from the local market (55%) and international market (45%). With a high debt, the company incurs high finance costs which affect profitability. The increase in borrowings was caused by poor servicing of some of the loans, whereby interests not paid and penalties increased the loan balances. These issues coupled with poor cashflow and accumulated losses should be considered in aggregate while assessing the going concern of the company.

IFRS 9 accounting treatment requires using a correct interest cost based on effective rate rather than a fixed interest rate, especially considering that the increase in borrowings was caused by poor servicing of some of the loans, whereby interests not paid and penalties increased the loan balances, an increase in interest rate was imposed this year by the lenders. There is a risk that Connected Rwanda has appropriately classified the loans as financial liabilities carried at amortized cost.

Other risks of material misstatements include:

- Airtime – potential errors in the charging system "CompX" resulting in incorrect amounts of revenues recognized which leads to likely or potential refunds to the customers (overstated revenue and understated liabilities).

- Internet data - potential errors in the charging system "QantX" resulting in incorrect amounts of revenues recognized which leads to likely or potential refunds to the customers as the client has no control over the charging system or assurance of a proper application of charge-out rates to customers. (overstated revenue and understated liabilities).

- Potential penalties / fines by RURA if the client is found liable to the claims raised by the customers (and this point may also be used in the points under "internal control deficiencies" as its this reason that non-compliance to the RURA standards may emerge)

Part (d): Your engagement partner has requested you to use analytical procedures on financial and non-financial data to ensure that they help you to identify risky areas and anomalies as you conduct a risk-based audit. Explain how analytical procedures would assist you in this process?

Analytical audit procedures are important for assessing the financial health and performance of a telecommunication company. These procedures involve the analysis of financial and non-financial data to identify trends, anomalies, and potential issues. Here's a step-by-step guide on how to use analytical audit procedures for a telecommunication company:

Understand the Telecommunication Industry:

Before starting the audit, it's essential to have a good understanding of the telecommunication industry, its regulatory framework, and specific risks associated with it. This knowledge will help you tailor your analytical procedures to the industry's unique characteristics.

Set Audit Objectives:

Define your audit objectives clearly. What do you want to achieve with your analytical procedures? Common objectives may include assessing revenue recognition, expense management, and compliance with industry regulations.

Gather Financial Data:

Collect financial statements, general ledger records, trial balances, and any other relevant financial data. You should also obtain industry-specific reports and data, such as subscriber counts, average revenue per user (ARPU), churn rates (which is the percentage of customers who close their contract or subscription with your company in any given time period), and capital expenditure reports.

Select Analytical Procedures:

Choose the analytical procedures you want to use. These can include ratio analysis, trend analysis, benchmarking, and variance analysis. Consider industry specific KPIs and financial metrics, such as EBITDA margins, average revenue per user, and customer acquisition costs.

Perform Ratio Analysis:

Calculate and analyze financial ratios, such as debt-to-equity ratio, current ratio, and return on assets. Compare these ratios to industry benchmarks to identify any deviations.

Trend Analysis:

Analyze trends in revenue, expenses, and other key financial indicators over multiple periods. Look for significant changes or inconsistencies and investigate their causes.

Benchmarking:

Compare the company's financial performance and ratios to industry peers or competitors. This can provide insights into areas where the company may be underperforming or outperforming.

Variance Analysis:

Identify significant variances between budgeted and actual financial figures. Investigate the reasons behind these variances and assess their impact on the company's financial health.

Analyzing Revenue Recognition:

Pay close attention to revenue recognition practices, as this is a critical area for telecommunication companies. Ensure that revenue is recognized in accordance with applicable accounting standards (e.g., IFRS 15) and that customer contracts are appropriately evaluated.

Compliance with Regulations:

Verify the company's compliance with industry-specific regulations and standards, such as those related to data privacy, customer data protection, and telecommunications licensing.

Non-Financial Data:

Don't limit your analysis to financial data only. Consider non-financial data, such as customer satisfaction surveys, network performance metrics, and customer complaint records. This can provide valuable insights into the company's operational health.

Document Your Findings:

Thoroughly document your analytical procedures, findings, and any issues or anomalies you uncover during the audit. This documentation is essential for the audit report.

Communicate with Management:

Discuss your findings with the company's management. Address any concerns and provide recommendations for improvements if necessary.

QUESTION TWO: TGL

Marking Guide to Question two: TGL

Q2 (a): With reference to ISA 510: initial audit engagements - opening balances, explain your audit procedures that shall be applied to review TGL opening balances.

Award up to 2 marks for every well explained point specific to TGL with a maximum of 8 marks. (1 mark for identification and 1 mark for explanation).

Q2. (b) Evaluate the impact of the above discussed issues on opening balances on the current year's audit.

Award up to 2 marks for every well explained point specific to TGL with a maximum of 10 marks. (1 mark for identification and 1 mark for explanation).

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

Q2. (c) Assume the CFO has requested your audit firm was hired to advise TGL on the adoption of ESG and sustainability reporting, Advise on how the group should approach ESG and sustainability reporting.

Award up to 1 mark for every well explained point with a maximum of 7 points for marks.

Total marks for Question Two **25**

Model Answer to Question two: TGL

Part (a): Explain your responsibilities on initial audit engagements - opening balances and show how they apply to the audit of TGL.

- As the auditor, you shall read the most recent financial statements (2021), if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures.
- The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:
  - Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated;
  - Determining whether the opening balances reflect the application of appropriate accounting policies; and
- Performing one or more of the following:

(i) Since the prior year financial statements were audited, reviewing the predecessor auditor's working papers to obtain evidence regarding the opening balances;
(ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
(iii) Performing specific audit procedures to obtain evidence regarding the opening balances.

- If you obtain audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, you shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. If you conclude that such misstatements exist in the current period's financial statements, you shall communicate the misstatements with the appropriate level of management and those charged with governance in accordance with ISA 450.

Part (b): Impact of the discussed issues on opening balances on the current year's audit.

Issue on opening balance	**Impact on audit of financial statements**
Damaged machinery at Best Roads Ltd worth FRW 2000 million.	The machinery carrying amount is 13% of the total non-current assets at Best Roads Ltd and 9.5% of the Group consolidated noncurrent assets. This therefore means that it is material. Management is unsure if the machinery was damaged in January 2022 or prior to that. In case the damage occurred in 2021, then it means that the non-current assets and the retained earnings were overstated by 2,000 less any recoverable amount. This means that

Issue on opening balance	Impact on audit of financial statements
	further investigation needs to be undertaken to find out whether this affects the opening balances. There is a need to establish whether the damage could have made the machinery fully obsolete or will need to be repaired. In case it's fully damaged, the total carrying amount should be written off. In case a repair would be needed, an impairment assessment would be needed and the lesser of the carrying amount and recoverable value should be considered.
Inventory of construction materials worth FRW 4,000 million transferred from Best Roads Ltd to Tubeheza Ltd, where it was recognized and valued it at FRW 2,500 million only.	The difference in the values of the inventory could be due to "inventory in transit" from Best Roads Ltd to Tubeheza Ltd. The difference of FRW 1,500 million should be investigated and establish how this was treated in the accounting records of both companies and in the consolidated accounts. There is a need to establish whether the inventory was transferred at a cost or cost plus (as a sale). You should also enquire about how the difference was treated in the financial statements of both companies and in the consolidated financial statements. While reviewing for opening inventory balance, you should ensure that the inventory is recognized at cost. In case part of the inventory was lost or damaged during the transfer, the opening balance should be adjusted accordingly.
Lawsuit of two former employees at Best Roads Ltd worth FRW 500 million.	This transaction was recognized as a provision in last year's operating expenses. Since the court case was dismissed in the current year with no legal penalty charged to Best Roads Ltd, this is not an accounting error in the prior year's profit or loss as it was estimated at the end of the prior year that it was highly probable that Best Roads Ltd was going to be liable to the penalty of FRW 500 million. The dismissal of the legal claim is not accounted for prospectively and hence no adjustment will be required on the opening balances.

Issue on opening balance	Impact on audit of financial statements
	However, this FRW 500 million should be reversed by impacting the reduction in the current year's provision – which affects the net profit of the current year.
Refusal by the predecessor auditor to share his working papers on prior year's figures	This would mean that the current year's auditor would use alternative procedures to review opening balances, such as reviewing supporting documents for those opening balances. This may, however, pose challenges on certain accounts such as inventory, where the current auditor did not attend the physical inventory count. This can lead to the modification of the audit opinion in case inventory is a material item.
Appreciation of non- current assets held for sale by FRW 500 million (i.e., FRW 6,000 million from the potential customer for the assets compared to FRW 5,500 million recorded in the prior year financial statements)	IFRS 5 states that non-current assets held for sale should be recognized at the lower of the carrying amount and fair value less costs to sell. Therefore, the current appreciation in value does not affect the opening balance as the carrying amount of FRW 5,500 million is lower than the appreciated value of FRW 6,000 million which is in agreement to IFRS 5. In case the sale is made this year, a gain or loss arising on the disposal (based on the difference between the carrying amount and sale value less the cost of sale on the date of the sale) should be recognized in the profit or loss of the year of the sale.

Part (c): Advise on how the group should approach ESG and sustainability reporting.

There is a growing importance of ESG and Sustainability reports supported by the fact that the investors and other stakeholders are calling on companies to disclose more information about their sustainability and environmental, social and governance strategies.

Below is the key information about how TGL can report on ESG and sustainability for investors and other stakeholders:

Corporate Governance

- Ensure that the report contains disclosures adequate for a reader to understand the future direction and risk(s)
- The report should be easy to be understood by users of the financial reports
- The report should have the necessary explanations on corporate governance regarding the various leadership levels and their roles
- The report should contain brief information about the background of the directors and their qualifications and designations (profiles)
- The report should have disclosures adequate to facilitate the reader an understanding of the entity
- The report should contain information on corporate social responsibility, if there is any, and their sustainability.

ESG and sustainability reporting

- The report should contain a brief on people and Sustainable Development Goals (SDGs) performance.
- The entity should make disclosures on the impact of its activities on the environment and climate change.
- A description of the organisation's strategy and approach to the environment and sustainability.
- The Report should have a description of the methods employed by the company to educate staff on environmental issues and how the company can improve its performance in this area.
- A description of how environmental factors are accounted for in investment appraisal.
- Statement of an organisation's carbon footprint.

QUESTION THREE: BBG Group Ltd

Marking Guide to Question two: BBG Group Ltd

Q3 (a): Advise your engagement team on the objective and nature, timing and extent of obtaining evidence on BBG Group Ltd's engagement in line with ISAE 3000 (Revised), assurance engagements other than audits or reviews of historical financial information.

Award up to 1 mark for each objective with a maximum of 4 marks and 2 marks for each evidence gathering with a maximum of 6 marks with a maximum of 10 points for marks

Q3. (b)In line with ISAE 3000, Explain what type of assurance on integrated annual report that can be issued.

Award up to 1.5 marks for every well explained type of assurance with a maximum of 3 points for marks.

Q3. (c) Evaluate key assurance challenges that you are likely to encounter during this engagement.

Award up to 2 marks for every well explained point with a maximum of 10 points for marks.

Q3. (d) With clear examples, explain the impact that non-financial matters such as social and environmental may have on the financial statements of BBG Group.

Award up to 1 mark for every well explained point with a maximum of 2 points for marks.

Total marks for Question Three **25**

Model Answer to Question three: BBG Group Ltd

Part (a): Advise your engagement team on the objective and nature, timing and extent of obtaining evidence on BBG Group Ltd's engagement in line with ISAE 3000 (Revised), assurance engagements other than audits or reviews of historical financial information.

Objectives:

In conducting this assurance engagement, your objectives are the following:

- To obtain either reasonable assurance or limited assurance, as appropriate, about whether BBG Group annual integrated report is free from material misstatements;
- To express a conclusion regarding the outcome of the measurement or evaluation of the underlying subject matter through a written report that conveys either a reasonable assurance or a limited assurance conclusion and describes the basis for the conclusion.
- To communicate further as required by this ISAE 3000 and any other relevant ISAEs
- In all cases when reasonable assurance or limited assurance, as appropriate, cannot be obtained and a qualified conclusion in your assurance report is insufficient in the circumstances for purposes of reporting to the intended users, ISAE 3000 requires that the

practitioner (you) to disclaim from providing a conclusion or withdraw (or resign) from the engagement (such as BBG Group review integrated report), where withdrawal is possible under applicable law or regulation.

Nature, timing and extent of obtaining evidence on BBG Group Ltd's engagement in line with ISAE 3000:

As a practitioner, you will choose a combination of procedures to obtain reasonable assurance or limited assurance, as appropriate for the review of integrated annual report. The procedures listed below may be used, for example, for planning or performing this engagement, depending on the context in which they are applied by you and your team:

- Inspection;
- Observation;
- Confirmation;
- Re-calculation;
- Re-performance; ·
- Analytical procedures; and
- Inquiry

Factors that may affect the practitioner's selection of procedures include the nature of the underlying subject matter such as the integrated annual report; the level of assurance to be obtained; and the information needs of the intended users and the engaging party, including relevant time and cost constraints.

In some cases, a subject matter specific ISAE may include requirements that affect the nature, timing and extent of procedures. For example, a subject matter specific ISAE may describe the nature or extent of particular procedures to be performed or the level of assurance expected to be obtained in a particular type of engagement. Even in such cases, determining the exact nature, timing and extent of procedures is a matter of professional judgment and will vary from one engagement to the next.

In some engagements, the practitioner may not identify any areas where a material misstatement of the subject matter information is likely to arise. Irrespective of whether any such areas have been identified, the practitioner designs and performs procedures to obtain a meaningful level of assurance.

An assurance engagement is an iterative process, and information may come to the practitioner's attention that differs significantly from that on which the determination of planned procedures was based. As the practitioner performs planned procedures, the evidence obtained may cause the practitioner to perform additional procedures. Such procedures may include asking the measurer or evaluator to examine the matter identified by the practitioner, and to make adjustments to the subject matter information if appropriate.

Part (b): In line with ISAE 3000, Explain what type of assurance on integrated annual report that can be issued.

In line with ISAE 3000 and generally other ISAEs, Either a reasonable assurance engagement or a limited assurance engagement:

- **Reasonable assurance engagement—**An assurance engagement in which as practitioner you reduce engagement risk to an acceptably low level in the circumstances of the engagement as the basis for your conclusion. Your conclusion as a practitioner is expressed in a form that conveys your opinion on the outcome of the measurement or evaluation of the underlying components of BBG Group Ltd integrated reports against criteria.
- **Limited assurance engagement—**An assurance engagement in which the practitioner reduces engagement risk to a level that is acceptable in the circumstances of the engagement but where that risk is greater than for a reasonable assurance engagement as the basis for expressing a conclusion in a form that conveys whether, based on the procedures performed and evidence obtained, a matter(s) has come to the practitioner's attention to cause the practitioner to believe the subject matter information is materially misstated. The nature, timing, and extent of procedures performed in a limited assurance engagement is limited compared with that necessary in a reasonable assurance engagement but is planned to obtain a level of assurance that is, in the practitioner's professional judgment, meaningful. To be meaningful, the level of assurance obtained by the practitioner is likely to enhance the intended users' confidence about the subject matter information (BBG Group Ltd integrated report) to a degree that is clearly more than inconsequential.

Part (c): Evaluate key assurance challenges that you are likely to encounter during this engagement.

Key assurance challenges likely to encounter on this integrated annual report assurance engagement include:

- Determining the scope of this integrated annual report assurance engagement, which can be complex. Unlike for audit of financial statements, it expected that agreeing with BBG Group management about the scope of this assignment will pause a challenge, being a new type of assignment, whose understanding is still vague.
- Evaluating the suitability of criteria in a consistent manner. The suitability of criteria to be used on areas such as corporate governance, sustainability, corporate social responsibility will definitely pause a big challenge.
- Addressing materiality for diverse information with little guidance in integrated reporting frameworks. There are many frameworks on integrating reporting such as Global Reporting Initiative (GRI), International Integrated Reporting Council (IIRC) and other many more. Some organizations even develop their tailor-made reporting frameworks.
- It will be a challenge to develop relevant assertions for subject matter information of a diverse nature of the engagement to review the integrated reporting.
- Lack of maturity in governance and internal control over integrated reporting processes
- It is never easy to provide an assurance in respect to the narrative information in an integrated reporting engagement.

- It may not be easy to provide an assurance on an integrated report specifically in respect to future-oriented information and assumptions.
- The professional accountant will not be able to apply the required professional skepticism and professional judgment in an engagement to review integrated reporting
- The professional accountant may not have the adequate competence necessary to perform the engagement to review the integrated reporting for example in terms of skills and experience
- The professional accountant may not communicate effectively the findings and conclusion in the assurance report

Part (d): With clear examples, explain the impact that non-financial matters such as social and environmental may have on the financial statements of BBG Group

As part of planning the audit, the auditor should be aware of any environmental regulations the entity may be subject to and any key social issues arising during the course of their operations. The auditor should review the BBG Group's quality control documentation and the results of any environmental audits carried out.

Examples of the impact of social and environmental matters on the BBG Group financial statements may include:

- Contingent liabilities, for example from non-compliance with environmental regulations.
- Asset values adjusted regarding impairment losses for purchased goodwill.
- Capital/revenue expenditure to ensure compliance
- Development costs,
- Going concern issues

QUESTION FOUR

Marking Guide to Question Four: KCL

Q4 (a) i) Clearly Explain the steps used in recognition of revenue from contracts in line with IFRS 15 for KCL clients

Award up to 1 mark for each step with a maximum of 5 marks.

Q4. (a) (ii) Evaluate the impact of the above transactions on the audit of KCL financial statements for the year ended 30 June 2023.

Award up to 1.5 marks for every well explained impact with a maximum of 3 marks under each issue. Total marks are 12.

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

Q3. (b) Advise your audit partner about the considerations to be made before accepting appointment or bidding for a parent group company.

Award up to 2 marks for every well explained point with a maximum of 8 points for marks.

Total marks for Question Three **25**

Model Answer to Question four: KCL

Part (a): (i) Clearly Explain the steps used in recognition of revenue from contracts in line with IFRS 15 for KCL clients.

The audit of revenue requires the application of the 5 steps from IRS 15:

Step 1 - Identify contracts in place with customers of KCL. Audit objective is about completeness to ensure that all contracts for the period under review were identified. This can be tested on a random basis.

Step 2 - Identify performance obligations in each contract with the customer. Audit objective is to ensure obligations in terms of milestone are considered in line with the said contracts to ensure that revenue is recognized appropriately.

Step 3 - Determine transaction prices for each contract. Audit objective here is about accuracy. This is to ensure that the correct contract amount is consistent with the contract value – in consideration of taxes and other deductions.

Step 4 - Allocate transaction prices to performance obligations in each contract. Audit objective here is about accuracy and computation using step 2 and step 3 by ensuring that how much to be recognized per performance obligation or milestone is identified.

Step 5 = Recognise revenue on satisfaction of a performance obligation in accordance with each contract. Audit objective here is about accuracy, completeness and cut off using step 4by ensuring that the correct amount is recognized in the correct period once a satisfaction of a milestone is achieved. Again, this can also be tested on a sample basis.

Part (a): (ii) Evaluate the impact of the above transactions on the audit of KCL financial statements for the year ended 30 June 2023.

Transaction	**Impact on audit of financial statements**
FRW 5 billion from the Ministry of Defense	The contract period is for 3 years. Which means that the revenue will likely be spread across those 3 years. There is a risk that KCL management recognized the paid advance of 50% (FRW 2.5 billion) in the current year under audit. In line with IFRS 15, this should not be recognized as revenue on the date it is received (August 2022) since there wasn't any performance obligation at the time of receiving that advance. Therefore, when received, it ought to be recognized as unearned revenue (or deferred income), which is a liability. The management, however, ought to have followed IFRS 15 at the end of the year to identify what performance obligations were satisfied and recognize the revenue accordingly. There are also business risks in case KCL loses this major client. If the contract revenue was to be spread over 3 years, this would generate FRW 1.6 billion – which is more than 10% of total revenue. Also, the Ministry of defense is a reputable client that losing them could lead to losing other clients.
5-storey office building that will be used as office and rented out.	The owner-occupied element of the property is recognized under IAS 16 property plant and equipment whereas the element to be rented-out of the building is recognized under IAS 40 – investment property. In this scenario 20% of the building cost (20% x FRW 1.5 billion = FRW 300 million) is an owner-occupied office building which should be recognized as "property, plant & equipment" while (80% x FRW 1.5 billion) FRW 1.2 billion of the property is intended for use by tenants and should be classified as an investment property. To make this classification, you should review the supporting documents to identify whether it is accurate

Transaction	Impact on audit of financial statements
	or whether the decision about the use of the building was approved by responsible parties – such as the board and whether the 20-80 portion are likely to keep changing. In case there is a constant change of the ratio, management can choose to recognize the entire building under IAS 16 property plant and equipment.
Materials worth FRW 200 million used on own-building were charged to clients and a portion of FRW 50 million was booked as expenses.	The construction materials ought to be recognized on the own-building and therefore as an item of "property, plant and equipment" under IAS 16. Therefore, the PPE is understated by FRW 200 million and cost of sales is overstated by 150 million. Having charged FRW 50 million as an expense, this impacted on the cost of sales, though the net profit may not be affected, proper classification of costs is a requirement.
A property built for the client "Shema business Ltd" for an agreed contract value of FRW 800 million. The client could not pay the outstanding balance of FRW 300 million and KCL agreed amicably with Shema business Ltd to transfer ownership of the building from Shema Business Ltd to KCL and KCL to pay Shema Business Ltd a balance of FRW 700 million within 2 years	Assuming that the property was built and completed within the year, recognizing this as revenue was correct as revenue is recognized when earned and not when it is paid. The settlement to transfer the ownership from the client due to unpaid FRW 300 million and pay them off FRW 700 million within 2 years has the following impact: - Revenue is overstated and FRW 800 million will be reversed. - The property will be recognized under KCL books at cost – FRW 700 million - Receivable of FRW 300 million will be reversed and payables of FRW 700 million recognized.

Part (b): Explain to your audit partner the considerations that should be considered by your firm before accepting the appointment or bidding for a parent company of the group.

In line with ISA 600 (Revised): Special Considerations—Audits of Group Financial Statements, the group auditor should consider whether or not their participation is sufficient to be able to act as the group auditor. For this purpose, the group engagement partner must obtain an understanding of the group before acceptance or bidding which should include the following:

- The materiality of the portion of the financial statements which the group auditor audits (and therefore, by implication, the proportion that they do not audit). Since the group has subsidiaries, check the materiality of the group and subsidiaries to be audited versus those to be audited by component auditors.
- The group auditor's degree of knowledge regarding the business of the components. Since the group and subsidiaries are in different businesses such as mining, trading and manufacturing, ensure that your audit of group and selected subsidiaries aligns with ehe firms and audit team’s knowledge and experience.
- The risk of material misstatements in the financial statements of the components audited by the component auditor (s). assessing the risk of material misstatements posed by not auditing the component audits. Some subsidiaries may pose significant risks of material misstatements on the group financial statements compared to others and the group auditor should have this into consideration.
- The ability, where necessary, to perform additional procedures to enable them to act as group auditors. In case, when necessary, the group auditor should be allowed to perform additional audit procedures on component audits to address the audit risks.
- The nature of the group auditor's relationship with the firm acting as component

Under ISA 600, the group auditor will consider also the following:

- The quality of work from component auditors;
- The ability of the group auditor to get involved with component auditors to obtain sufficient appropriate audit evidence if necessary; or
- The availability of information on consolidation from the client.
- If the group auditor has concerns about any of these issues and is unlikely to be able to deliver anything other than a disclaimer of opinion, they should not consider either accepting or continuing with the engagement (ISA 600: para. 13).

END OF MARKING GUIDE AND MODEL ANSWERS