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**CERTIFIED PUBLIC ACCOUNTANT  
INTERMEDIATE LEVEL EXAMINATIONS**

**11.4: AUDITING**

**DATE: FRIDAY 01, DECEMBER 2023**

**MARKING GUIDE AND MODEL ANSWERS**

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## **SECTION A**

### **QUESTION ONE**

#### **Marking guide**

<b>Sub question</b>	<b>Criteria</b>	<b>Marks</b>
<b>(a)</b>	2 marks on each of the 3 or any other that is relevant, Maximum 6 marks	<b>6</b>
<b>(b)</b>	3 marks max to each of the highlights with 1 mark for each correct response under each highlight under any highlight, Maximum 12 marks	<b>12</b>
<b>(c)</b>	1 mark for each source of information, Maximum 2 marks	<b>2</b>
<b>Total for question 1</b>		<b>20</b>

#### **Model answers**

**a) Objectives of obtaining an understanding of KBG environment is relevant to your engagement:**

- To identify and assess the risks of material misstatement in the financial statements of KBG.
- To enable the you to design and perform further audit procedures in regard to the issues highlighted or any other that you may encounter during your audit.
- To provide a frame of reference for exercising audit judgement, for example, when setting audit materiality for KBG financial statements. (ISA 315 (Revised)).

**b) Below are the suggested responses in regard to the KBG highlighted issues in the audit of its financial statements for the year ended 31 December 2022.**

#### **Resignation of the Finance Manager**

- The auditor should enquire from senior management about further details of his resignation and design audit procedures to address any risks that might have been resulted thereof. For example, if he resigned as a result of identified misappropriation of asset or fraud, the audit should design audit procedures to find out the impact of material misstatement to KBG financial statements. The auditor may also reduce reliance on controls and perform more substantive testing.
- The information received should be corroborated with other documents such as minutes of the senior management or the board.
- You should also assess the impact of his resignation on the period after July 2022.

### **Accounting software crashed during the month of November 2022**

- This will impact the completeness assertion on most if not all financial statement account balance and therefore this is pervasive.
- You should enquire about the exact time when the system was not functional and enquire from management about the time bound (how many days) that was affected.
- In a bid to assess the impact of this crash, you can compare the level of transactions for similar period last year.
- The auditor should ascertain the progress of reconciliation and reposting of missing transactions. He/she should ascertain whether this was completed or ongoing during the audit period. The auditor should assess the impact of this on material misstatement of the financial statements as a whole and issue his/her opinion appropriately.

### **Decrease of 10% of total revenue and a decrease of 5% of total expenditure compared to the previous year.**

- Auditor should assess the impact of the reduction of 5% of profit, conserving other factors constant.
- The auditor should perform trend analysis and see past performance and projected performance. If the reduction in revenue has been there for the last say 5 years, the auditor should assess KBG's going concern.
- The auditor should also compare KBG's performance with the whole industry and other companies in the industry to find out whether this was affected by factors affecting the industry as a whole or it was only specific to KBG.
- Enquire from management what was behind this performance and assess the company's future projections.

### **One of the key machineries was damaged due to electricity and it is under repair.**

- The auditor should check for the machinery's book value in the books of accounts.
- Check whether the management has conducted impairment assessment on this machinery and other assets in line with IAS 36.
- If impaired, check whether the transaction was posted in the accounting records and the current book value is relative to the machinery's market value less cost for proceeds.

### **c) Other sources of information that can help the auditor to obtain an understanding of the entity and its environment**

- The permanent audit file where information of continuing importance to audit is kept.
- Audit working papers from the previous year's audit file
- Information from the client's website
- Publications or websites related to the industry the client operates in
- etc



## QUESTION TWO

### Marking guide

Sub question	Criteria	Marks
(a)	1 mark for each point, Maximum of 4 Marks	4
(b)	1 mark for control objective, 0.5 mark for assertion and 1 mark on each test of controls identified. Only 4 control objectives were required, Maximum 10 marks	10
(c)	2 marks for each correct assertion and corresponding substantive test- 0.5 and 1.5 marks respectively, Maximum 6 marks	6
<b>Total for question 2</b>		<b>20</b>

### Model answers

**a) Why it is important to test controls around cash and cash equivalent regardless its materiality to the financial statements**

- Cash and cash equivalents are inherently the asset that are most susceptible to fraud and misappropriation.
- Liquidity is as good as profitability to the company. An entity with positive profitability can still be declared bankrupt due liquidity challenges in case it becomes unable to meet its short term and long-term obligations such as paying suppliers, employees, etc.
- Teeming and lading: a type of fraud where there is a delayed banking of company's money. Or where one takes the company's money for personal business and returns it at a later stage.
- In case of theft, it is hard to recover, unlike inventory and other PPE items.

**b) Control objectives at Innovation Rwanda Ltd and their corresponding assertions and propose relevant test of controls to be conducted on cash receipts and cash payments through the bank:**

Control objective	Assertion	Test of controls
To ensure that only valid cash receipts are received and deposited	Occurrence	<ul style="list-style-type: none"><li>• Observe the processing of cash receipts and review the entity's policies to evaluate whether proper segregation of duties is operating.</li><li>• Examine application controls for electronic cash receipts transfer.</li><li>• Review monthly bank reconciliations to confirm performed and reviewed.</li><li>• Observe cash sales procedures and trace whether the corresponding commission was received and traced to the bank/mobile money account.</li></ul>

<b>Control objective</b>	<b>Assertion</b>	<b>Test of controls</b>
To ensure that only valid cash payments are made	Occurrence	<ul style="list-style-type: none"> <li>• Observe the processing of cash payments and review Innovation Rwanda Ltd policies to evaluate whether proper segregation of duties is operating.</li> <li>• Review the procedures for reconciling supplier statements</li> <li>• review delegated list of authority for cash payment.</li> <li>• Inspect relevant documentation for evidence of approval by senior personnel.</li> </ul>
To ensure that all cash receipts are recorded	Completeness	<ul style="list-style-type: none"> <li>• Observe the processing of cash receipts and review the entity's policies to evaluate whether proper segregation of duties is operating.</li> <li>• Examine application controls for electronic cash receipts transfer.</li> <li>• Review monthly bank reconciliations to confirm performed and reviewed. Reperform a sample of the reconciliations.</li> <li>• Review reconciliation.</li> <li>• Enquire of management about handling of customer statements.</li> </ul>
To ensure that cash payments are recorded correctly in the ledger	Accuracy, valuation and allocation; and classification.	<ul style="list-style-type: none"> <li>• Review reconciliation, to ensure performed, reviewed and any discrepancies followed up on a timely basis.</li> <li>• Review reconciliations for a sample of accounts</li> <li>• Review bank reconciliation for evidence it was done and independently reviewed. Reperform a sample of bank reconciliations.</li> </ul>
To ensure that cash receipts/ payments are recorded in the correct accounting period	Cut off	Review and test reconciliation.



**c) Assertion(s) and proposed substantive audit procedures to be conducted on cash receipts and cash payments through the petty cash and mobile money.**

<b>Assertion</b>	<b>Substantive testing</b>
Completeness	Agree the TB balances with the ledger for petty cash and mobile money payments and receipts.
Accuracy and occurrence	<ul style="list-style-type: none"> <li>• Select a sample for testing on receipts and payments from petty cash and mobile money and agree the recorded amount to the supporting document.</li> <li>• Ensure that the supporting document are genuine and amounts are clearly written.</li> <li>• Obtain petty cash count certificate.</li> <li>• Check the closing balance on the mobile money account statement</li> </ul>
Cut off	<ul style="list-style-type: none"> <li>• Check whether the recorded amounts belong to the period under audit by confirming it on the supporting documents.</li> <li>• Check for those transactions that were made but reflected on the mobile money statement on a different date (especially those transactions made over the weekend).</li> </ul>
Accuracy, valuation and allocation; and classification.	<ul style="list-style-type: none"> <li>• Review reconciliation on petty cash, to ensure performed, reviewed and any discrepancies followed up on a timely basis.</li> </ul>

### QUESTION THREE

#### Marking guide

Sub question	Criteria	Marks
(a)	1 mark for each principle explained, Maximum of 5 Marks	5
(b)	1 mark for each correct threat, 1 mark for each fundamental principle and 1 mark for each corresponding safeguard identified, Maximum 12 marks	12
(c)	1 mark for each circumstance, Maximum 3 marks	3
Total for question 3		20

#### Model answers

##### a) Identify and explain the fundamental ethical principles for professional accountants in accordance with IESBA code of ethics

There are five fundamental principles of ethics for professional accountants:

- (1) **Integrity** – to be straightforward and honest in all professional and business relationships.
- (2) **Objectivity** – to exercise professional or business judgment without being compromised by:
  - ✓ Bias;
  - ✓ Conflict of interest; or
  - ✓ Undue influence of, or undue reliance on, individuals, organizations, technology or other factors.
- (3) **Professional Competence and Due Care – to:**
  1. Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and
  2. Act diligently and in accordance with applicable technical and professional standards.
- (4) **Confidentiality** – to respect the confidentiality of information acquired as a result of professional and business relationships.
- (5) **Professional Behavior** – to:
  1. Comply with relevant laws and regulations;
  2. Behave in a manner consistent with the profession's responsibility to act in the public interest in all professional activities and business relationships; and
  3. Avoid any conduct that the professional accountant knows or should know might discredit the profession.



**b) Identify threats and breaches to the fundamental ethical principles, propose safeguards that may reduce threats to an acceptable level.**

<b>Event</b>	<b>Threat(s) to fundamental ethical principles</b>	<b>Fundamental ethical principles breached/may be breached</b>	<b>Proposed safeguard(s)</b>
Fraudulent transactions passed by the Senior Accountant	Self interest	Integrity, Objectivity and professional competence and due care	<ul style="list-style-type: none"> <li>- The auditor should uphold his integrity and refuse the money as proposed by the Senior Accountant.</li> <li>- The auditor should report fraudulent transactions as identified. He should discuss this with his supervisor at his firm.</li> <li>- The Senior Accountant has breached several fundamental ethical principles including integrity, objectivity and professional competence and due care. Since he has already breached those principles, they may not be any safeguards. His employer may decide to terminate their professional relationship.</li> </ul>
A junior accountant who lied about having completed CPA qualification	Self interest	Integrity, and professional competence and due care	<ul style="list-style-type: none"> <li>- The junior accountant has breached the said fundamental principles. He/she may not be able to serve his/her employer as required since he/she did not have required CPA qualification.</li> <li>- Since a breach has already been committed, his/her employer may terminate his/her contract or give a chance to him/her to complete the qualification.</li> </ul>
Chairman request to replace the current auditor and provide audit services for the	Self-interest and self-review	Objectivity and familiarity (possibly)	Your firm should not accept to become an auditor on the financial statements that it assisted to prepare. This would create a self-review threat.



Event	Threat(s) to fundamental ethical principles	Fundamental ethical principles breached/may be breached	Proposed safeguard(s)
financial statements that your firm assisted the company to prepare.			
CEO's threat to fire the entire finance and accounting department in case the organization receives a modified audit opinion.	Intimidation	Objectivity and professional competence and due care	<ul style="list-style-type: none"> <li>- This may create undue influence on the finance and accounting team. The Chairman and those charged with governance should request the CEO to remove that threat.</li> <li>- Accounting and finance team should also ensure that they provide required services to their employer to the best of their ability. In case of gap of knowledge, they should be facilitated to be trained.</li> </ul>

**c) Circumstances under which it is allowed to disclose confidential information to third party.**

1. Disclosure is permitted by the law and is authorized by the client or employer
2. Disclosure is required by law. for example:
  - Production of documents or other provision of evidence in the course of legal proceedings. or
  - Disclosure to the appropriate public authorities of infringements of the law that come to light: and
3. There is a professional duty or right to disclose, when not prohibited by law:
  - To comply with the quality review of ICPAR or another professional body;
  - To respond to an inquiry or investigation by ICPAR or a regulatory body;
  - To protect the professional interests of a professional accountant in legal proceedings', or
  - (iv) To comply with technical standards and ethics requirements:

## **SECTION B**

### **QUESTION FOUR**

#### **Marking guide**

<b>Sub question</b>	<b>Criteria</b>	<b>Marks</b>
<b>(a)</b>	1 mark each point, Maximum 3 marks	<b>3</b>
<b>(b)</b>	1 mark for each correct audit procedure with a maximum of 3 marks under each account balance, maximum of three audit procedures for every account balance, Maximum 12 marks	<b>12</b>
<b>(c)</b>	1 mark for each correct answer on written representation and 2 marks on analysis of management response on the going concern assessment, Maximum 5 marks	<b>5</b>
<b>Total for question 4</b>		<b>20</b>

#### **Model answers**

##### **a) Test objectives on opening balances**

For initial audit engagements, the auditor should obtain sufficient appropriate audit evidence that:

- The opening balances do not contain misstatements that materially affect the current period's financial statements;
- The prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated; and
- Appropriate accounting policies are consistently applied or changes in accounting policies have been properly accounted for and adequately presented and disclosed.

##### **b) audit procedures on opening balances**

#### **Inventory**

- Observing a current physical inventory count and reconciling it to the opening inventory quantities. This is also known as roll backward procedures
- Performing audit procedures on the valuation of the opening inventory items. (eg: valuation method, pricing etc)
- Performing audit procedures on cut-off. This may include reviewing purchases of inventory close to the year end and after.

#### **Property plant and equipment**

- Obtain the prior year asset register and PPE book value and apply depreciation.
- Test for new PPE additions for last year.



- Check of last year's disposals.
- Recompute the PPE movement schedule and agree with the PPE opening balances.

### **Receivables**

- Trace the prior receivables total to prior year general ledger.
- Trace prior year receivables invoice settlement by debtors in the current year.
- Obtain the prior year debtors aging and ensure that provision on accounts receivables was correctly done in line with the policies.
- Comparing prior year receivable balance vs opening balance of current year.

### **Payables**

- Trace the prior year payables total to prior year general ledger.
- Trace prior year payable invoices on the bank statement where they were paid by the company.
- Ensure that those invoices had been reported as expenditure from the current previous year.
- Comparing prior year payable balance vs opening balance of current year.

### **c) Objectives of written representations by management and whether management response will impact your going concern assessment**

ISA 580 Written Representations (para. 6) provides guidance to auditors in this area. The objective, of the auditor are:

- To obtain written representations that management believes that it has fulfilled the fundament responsibilities that constitute the premise on which an audit is conducted.
- To support other audit evidence relevant to the financial statements if determined by the auditor or required by other ISAs .
- To respond appropriately to written representations or if management does not provide written representations requested by the auditor.

### **Whether management response will impact your going concern assessment**

IKORA Manufacturing Ltd management has expressed that the going concern issue raised by the auditor will be covered in the written representation to be issued by showing future prospects of the company. Depending on the auditor's analysis of the response, he may issue his/her opinion on the accounts with going concern or not. If the going concern was raised by decreasing revenue, if for example IKORA has a new product that is proving to improve the company's performance, that may address the auditor's assessment. The company may also show how it is going to adopt efficient means of operations that may save cost.

However, in line with ISA 506: Emphasis of Matter paragraph – A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial

statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor may decide to disclose the going concern issue here.

## QUESTION FIVE

### Marking guide

Sub question	Criteria	Marks
(a)	2 marks for each subsequent event, Maximum 4 marks	4
(b)	1 Mark for identified event and 2 marks per provided explanation, Maximum 9 marks	9
(c)	1 mark for every correct step, Maximum 7 marks	7
<b>Total for question 5</b>		<b>20</b>

### Model answers

#### a) describing two types of subsequent events in accordance with IAS 10:

There are two types of events defined by IAS 10:

- **Adjusting events:** Those that provide evidence of conditions that existed at the year-end date.
- **Non-adjusting events:** Those that are indicative of conditions that arose after the year-end date.

#### b) Events are adjusting or non-adjusting events to the financial statements of JEKO ltd for the year ended 31 December 2022 and why.

Adjusting events	Non-adjusting events
<p><b>The fire that broke in the wood and timber warehouse and had a significant portion of the inventory burnt down.</b></p> <p>This is an adjusting subsequent event that occurred after the reporting period. The management has reported that the inventory burnt include the portion that is under closing inventory in the JEKO's financial statements. Once the value of the destroyed inventory is ascertained, an adjustment reducing the closing value of inventory should be passed.</p>	<p><b>A new competitor entering the market in the start of the year 2023:</b></p> <p>This is a non-adjusting event since it was not existing during the period under audit. Even though the competitor may be having better products than JEKO, full analysis of its impact is not yet fully substantiated. The auditor may however make an assessment of the going concern as a result of this and also consider JEKO's management response to this.</p>



**Motor vehicle with an engine that was severely damaged.**

This is an adjusting event since the motor vehicle has been there during the period under audit. This means that its book value reported in JEKO's accounts is overstated and therefore, the management should pass an impairment adjustment.

**c) The steps that your engagement partner should take before he/she forms his/her audit opinion on financial statements of JEKO Ltd**

- Ascertain whether all the evidence reasonably expected to be available has been obtained and has been evaluated.
- Assess whether the effect of not gaining sufficient and relevant evidence is such that the financial statements could be misleading as a whole or in material part.
- Ascertain whether the financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) or IFRS for SMEs.
- Assess whether any departure from the accepted accounting principles is required to give a true and fair view and has there been adequate disclosure.
- Assess whether any unnecessary departure from accounting principles is material or pervasive to the financial statements. A material departure will give an "except for" opinion while a pervasive departure will result in an adverse opinion.
- Conclude as a whole whether the financial statements give a true and fair view or else issue an appropriate modified opinion.

## QUESTION SIX

### Marking guide

Sub question	Criteria	Marks
(a)	1 mark for each audit assertion, Maximum 4 marks	4
(b)	1 mark for each correct audit procedure under the correct assertion, Maximum 10 marks	10
(c)	1 mark for each correct audit procedure, Maximum 6 marks	6
<b>Total for question 6</b>		<b>20</b>

### Model answers

#### a) 4 key audit assertions for the audit of accounts receivables:

Audit assertions for accounts receivable	
Existence	The accounts receivable that are shown on the balance sheet of the Hospital at the reporting date really exist.
Valuation	The amount of receivables recorded in the Hospital's account is mathematically correct and their balances reflect the actual economic value.
Completeness	All accounts receivable transactions that should have been recorded have been recorded.
Right and obligation	The Hospital has the right of controls on the accounts receivable included in the financial statements.

#### b) Audit procedures to address those assertions for the accounts receivable of the Hospital

Audit assertions for accounts receivable	
Completeness	<ul style="list-style-type: none"><li>• Agree the balance from the individual sales ledger accounts to the aged receivables' listing and vice versa.</li><li>• Match the total of the aged receivables' account, listing to the sales/revenue ledger control account.</li><li>• Cast and cross-cast the aged trial balance before selecting any samples test.</li><li>• Complete the disclosure checklist to ensure that all the disclosures relevant receivables have been made.</li><li>• Compare the level of prepayments to the previous year to ensure the figure is materially correct and complete.</li><li>• Review detailed statement of financial position to ensure all likely prepayments have been included.</li></ul>



Existence	<ul style="list-style-type: none"> <li>Perform a receivable circularization on a sample of year-end trade receivables. RSSB should be circularized considering that it accounts for 90% of the total receivables.</li> <li>Follow up all balance disagreements and non-replies to the receivable's confirmation.</li> <li>Check whether the amounts not approved by RSSB were written off by the Hospital.</li> <li>Perform alternative procedures for any exceptions and non-replies to the receivables confirmation, such as: <ul style="list-style-type: none"> <li>Review after-date cash receipts by inspecting bank statements and cash receipts documentation.</li> <li>Examine the customer's account and customer correspondence to assess whether the balance outstanding represents specific invoices and confirm their validity.</li> <li>Enquire from management explanations for invoices remaining unpaid after subsequent ones have been paid.</li> </ul> </li> </ul>
Valuation	<ul style="list-style-type: none"> <li>Compare receivables turnover and receivables collection period with the previous year and/or with industry data (comparison with other district hospitals), and investigate any significant differences.</li> <li>Compare the aged analysis of receivables from the aged trial balance with the previous year.</li> <li>Review the adequacy of the allowance for uncollectable accounts through discussion with management.</li> <li>Compare the allowance for irrecoverable debts as a percentage of receivables or credit sales with the previous year and/or with industry data.</li> <li>Confirm adequacy of allowance and adjustment of recorded invoices to insurance companies by reviewing correspondence with those insurance companies, RSSB in particular.</li> <li>Examine large customer accounts (RSSB) and compare with the previous year's balances.</li> <li>For a sample of old debts on the aged trial balance, obtain further information regarding their recoverability by discussions with management and review of RSSB correspondence.</li> <li>Review after-date cash receipts by inspecting bank statements and cash receipts documentation.</li> </ul>
Right and obligation	<ul style="list-style-type: none"> <li>Check whether those charged with governance of the Hospital have not discharged some receivables. For example, some patients who were not able to pay for their medical contribution.</li> </ul>

	<ul style="list-style-type: none"> <li>Confirm the total of receivables under each debtor with the total of its invoices</li> </ul>
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**c) Audit procedures on Bugesera District Hospital's payroll costs**

<b>Audit tests – Payroll cost</b>	
Occurrence	<ul style="list-style-type: none"> <li>Check pay rates to personnel records and contracts for the Hospital personnel.</li> <li>Check hours paid to timesheets, clock cards.</li> <li>Confirm existence of staff through face-to-face meetings, check phone book, discuss with managers etc.</li> </ul>
Accuracy	<ul style="list-style-type: none"> <li>Check accuracy of calculations of pay, and statutory deductions are correct.</li> <li>Check for supporting documentation in respect of other deductions to establish their validity and check the accuracy of the calculation by reperformance.</li> <li>Check for leavers and ensure that they were removed from the subsequent month's payroll.</li> </ul>
Completeness	<ul style="list-style-type: none"> <li>Check the arithmetic calculations on the payroll records.</li> <li>Confirm net payment to bank statement and payments book.</li> <li>Scrutinize the payroll for any unusual items.</li> <li>Review wages control account for any discrepancies.</li> </ul>

**END MARKING GUIDE AND MODEL ANSWERS**