CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.2: AUDIT PRACTICE AND ASSURANCE SERVICES

DATE: FRIDAY, 01 APRIL 2022

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. The question paper should not be taken out of the examination room.

SECTION A

QUESTION ONE

You are an audit manager in Kalisa Certified Public Accountants (CPA) a local audit firm registered in Rwanda. As part of understanding the client's business you are currently conducting an internal risk analysis of a new audit client Uwera Play Zone Ltd (UPZ Ltd) with a year ended 30th June 2021. UPZ Ltd is a private company incorporated in Rwanda with a large children recreation center operating in Kimironko which is in the outskirts of Kigali. The recreation center is open with a wide variety of children playing facilities and tools including swimming pools and a variety of children-specific play games. Most of the customers are children organized through establishments like schools, religious institutions and families. You are currently reviewing the internal controls and operating systems of UPZ Ltd's three of the main departments that include the Human resources, Procurement and Marketing departments.

UPZ Ltd employs on average 100 employees "Play Guides" stationed at the play center with most of these engaged as part-time workers who are on standby to be called in depending on the number of children visiting the play center in a day. The human resources department does not require the new workers to undergo a formal process of recruitment as the workers are handpicked from the neighborhoods. Except for a one-day standard orientation on recruitment no other training is given to the Play Guides in providing to care for the children by the company as these workers are assumed to have basic knowledge in handling children and the use of the playing equipment. The workers are supervised by "Play Guide supervisors" whose main role is to confirm that workers are in the allocated workplaces and this supervision is done regularly every three hours. The workers are paid monthly at the month end through the payroll which is processed in-house. The company does not provide regular feedback on the performance to the "Play Guides" and there is a lack of staff motivation schemes such as long-service awards, which contributes to the high staff turnover.

UPZ Ltd does not maintain an approved list of suppliers for its procurement of goods and services. The company buys its information technology (IT) equipment, other equipment, furniture, stationery, cleaning materials and staff uniforms from a variety of suppliers who are identified by the procurement officer when procurement of goods and supplies is required. The procurement office operates with only one staff (the procurement officer) who is responsible for all procurements including the approval of the procurement orders issued to suppliers. Uwera PZ does not operate with a procurement committee. All payments to the suppliers of the goods and services are paid in form of cash or bank transfers after the approval of the Finance Director.

UPZ Ltd has recently decided to outsource its marketing to a large, aggressive, third-party company that is now responsible to advertise UPZ Ltd 's services by means of direct mail, and sometimes by offering discounts to customers. This marketing company has been criticized in the past for breaching advertising regulations by the Rwanda authorities. There is a growing price competition in UPZ Ltd 's market and consequently the company is struggling to maintain its profitability and would therefore want to expand its customer base.

Required:

For each of the three main functions at UPZ Ltd (ignoring the information regarding the wages system in the additional information below), describe the:

(a) Business risks faced by UPZ Ltd that should be considered in the planning of the final audit (10 Marks)

(b) Controls that UPZ Ltd should put in place to manage the risks identified in (a) above (10 Marks)

(c) Tests of controls that your audit firm should perform to confirm that the controls identified in (b) above are operating effectively (10 Marks)

Note:

1. You may incorporate all the three requirements above by presenting your answer in a tabular format or present each point addressing all the three requirements.
2. Ignore the additional information provided below relating the wages & salary system of UPZ Ltd as this is meant to be used in answering parts (d) and (e) below.

Wages system for Play Guides

In addition to the information provided on the human resources of UPZ Ltd above, majority of the Play Guides are part-time shift workers who normally work a standard eight (8) hour schedule. The children play area is opened 7 days a week and Play Guides are required on each day. Most times the Play Guides operate overtime especially on busy days like weekends when most parents bring in their children.

Play Guides arrive at about 7 AM for work and "clock in" using an electronic identification card. The card is scanned by the time recording system and each staff's identification number is read from their card by the scanner. The staff is then logged in the system at that time as being at work. The staff salary payment system at the end of each month is electronically set to calculate payment for each staff on an hourly basis from the time the staff logs in with their electronic identification card. The staff logging in process is not monitored as it is assumed that the Play Guide will not work without first logging in on the time recording system.

The Play Guides are split into 5 groups of 20 members per group, with each group under the supervision of a "Play Guide Supervisor". Each group of Play Guides is allocated to a specific area within the children recreational center to provide guidance and support to the children while playing within the center. On average at least 200 children visit the center and this can grow to over 500 children visiting the center on weekends, public holidays and where there are promotional events.

Where necessary, overtime is worked on days where a big number of children visit the center. The Play Guide supervisor is not required to monitor the extent of any overtime working although the supervisor has to ensure that the Play Guides are out of the playing center when children are gone so that unnecessary overtime is not claimed. The Play Guides log off at the end of each day by re-scanning their electronic identification cards.

Payment of wages to Play Guides

The details of hours worked each month are sent electronically to the accounts department, where hours worked are allocated by the computerized wages system to each Play Guide's wage records. The payroll accountant compares the hours worked from the time recording system to the computerized wages system and enters a passcode to confirm the accuracy of the records transfer. The passcode also acts as authorization to calculate the monthly net wages for the Play Guides. The passcode is the first name of Finance Director and is also generally known to all staff of the accounts department.

In addition, the bank account details of each play guide are data captured by the payroll accountant and no one in the Human Resource records cross-checks this information with the human resource records.

Every month, the computerized wages system calculates for each Play Guide:

(i) Gross wages using the hourly rate for the standard 8-hours and any overtime worked;
(ii) Statutory deductions from the wages; and
(iii) The net pay

The computerized list of net pay for the Play Guides with their bank account details is then used by the payroll accountant to make final monthly wages payment to the play guides' bank accounts without any reviews or authorization. The payroll accountant makes payment to the Play Guides using UPZ Ltd 's online banking system. Every few months, the Finance Director reviews the total amount of wages paid to ensure that the management accounts are accurate.

Required:

(d) As the external auditors of Kalisa Certified Public Accountants (CPA), and as part of communications to those charged with Governance, write an extract of what will be included in the management letter to the directors of UPZ Ltd in respect of the Play Guides' wages recording and payment system in which you:
(i) Identify and explain FOUR internal control deficiencies in that system
(ii) Explain the possible implication of each deficiency
(iii) Explain an appropriate recommendation to address each deficiency

Notes:

1. Up to 2 Marks will be awarded in part (d) for presentation (14 Marks)
2. You may incorporate all the three requirements above by presenting your answer in a tabular format or present each point addressing all the three requirements.

Other information – senior management salary system

All senior management staffs including the Play Guide supervisors are paid monthly salaries with no overtime payments. Salaries to the senior management are increased by 5% every 6 months (in June and December) and annual bonus of 10% based on annual salary was paid in June 2021.

Required:

(e) List THREE substantive analytical procedures you should perform on the senior management salary system. For each procedure, state your expectation of the result of that procedure. (6 Marks)

(Total: 50 Marks)

SECTION B

QUESTION TWO

You are an audit manager in Akamwezi Associates Certified Public Accountants. One of your largest clients is Jean Paul Contractors (JPC), a limited liability private company which is a Group of companies with the parent company based in Remera in Kigali-Rwanda set up 15 years ago by two close friends while at university "Jean" and "Paul". JPC has a financial year of 30 June. JPC is among the largest construction companies in Rwanda that undertakes mainly "fixed fee" construction contracts that include construction of buildings for its customers that are used as offices, factories, schools and hospitals. Most contracts will be completed between 1-2 years from the start of the contract. JPC's customers include businesses and Rwanda local government departments. JPC opened up a subsidiary in Kenya five years ago with the same type of customers. In Rwanda, the quality of the construction is regularly monitored by the relevant authorities to avoid any inferior work in addition to the maintenance of health and safety for the construction workers.

Due to the effects of COVID-19, there has been recent cut-backs in the spending of the Rwanda local government departments which has resulted in fewer contracts being started by JPC in the year ended 30 June 2021 than budgeted. Due to the COVID-19 implications, JPC has relaxed its terms with the customers now allowing the customer to only make an advance payment of 40% of the contract price at the start of the construction and the balance all invoiced and received after 12 months after completion and handover of the building to the customer. As an attempt to cut down its own operating expenses, JPC has operated with only one accountant who works part-time and has never studied any professional accountancy course.

JPC's accounting policy for construction contracts in its financial statements states as follows:

"Revenue is recognized using the percentage of completion method applying the input method which is calculated on the basis of costs incurred as a percentage of expected total costs. Expected losses are provided for in full as soon as the possibility of loss is anticipated."

The direct costs that relate to specific contracts include:

(i) Materials supplied to the site
(ii) Transportation costs of resources (e.g materials, plant and labor) between sites
(iii) Costs of hiring portable buildings and leasing plant and machinery
(iv) Site labor costs (as allocated from the company payroll and sub-contractor's invoices)
(v)Site supervision costs (based on apportioned foremen's salaries)
(vi) Architect's design costs, legal fees and engineering assistance
(vii)Insurance and telephone
(viii) Depreciation of plant, machinery and vehicles

The indirect expenses incurred by JPC's head office in Remera relating to the construction activities are attributed to the construction projects at 80% of the direct costs.

In the prior year ending 30 June 2020, your audit firm qualified the auditor's report for JPC due to a lack of evidence to support the client's schedules of estimated costs of completion.

Required:

(a)Identify and explain the principal audit risks to be considered when planning the approach to the final audit of JPC for the year ended 30 June 2021. (10 Marks)

In addition to the information provided above, JPC Limited has a subsidiary based in Kenya incorporated as JPC Kenya Limited. The JPC consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS). The draft consolidated financial statements for JPC Group for the year ended 30 June 2021 show profit before tax of FRW 9.3 trillion (June 2020 – FRW 8.25 trillion) and total assets FRW 48.75 trillion (June 2020 – FRW 44.7 trillion).

The subsidiary JPC Kenya Limited is audited by another audit firm, Owande CPA, a local firm based in Kenya. Yesterday, you received Owande's draft auditor's report on the financial statements of JPC Kenya Limited for the year ended 30 June 2021 bearing the following extracts:

'Basis of audit opinion' (extract)

As set out in notes 3 and 4 of the financial statements, expenditure on the leases under the right-to-use leased assets has not been reflected in the statement of financial position but has been included in operating expenses and no provision has been made for deferred taxation. This is not in accordance with the local tax regulations.

'Opinion' (extract)

In our opinion, the financial statements present fairly the financial position of the company as of 30th June 2021 and of the results of its operations and its cash flows for the year then ended in accordance with …'

The financial statements of JPC Kenya for the year ended 30 June 2021 show translated profits before tax of FRW 2.85 trillion (June 2020 – FRW 2.55 trillion) and total assets of FRW 9.75 trillion (June 2020 – FRW 9.9 trillion).

The relevant notes in the financial statements of JPC Kenya Limited are as follows:

Note 3: Right-of-use leased assets

During the year ending 30 June 2021, JPC Kenya has incurred expenditure on leasing agreements that gives rights similar to ownership of fixed assets with a fair value of FRW 1.2 trillion. All lease payments are charged to the profit or loss as operating expenses when incurred.

Note 4: Taxation

This includes current taxes on profit and other taxes such as taxes on capital. No provision is required to be made for deferred tax and it is not practical to quantify the financial effect of unrecognized deferred tax liabilities.

Required:

(b) Comment on the matters your audit firm should consider before expressing an opinion on the consolidated financial statements of the JPC Group (10 Marks)

The Group Audit committee of the JPC Group has expressed their dissatisfaction over the company auditors of JPC Kenya for not identifying a major fraud taking place on the misuse of generally company assets in JPC Kenya Limited.

Required:

(c) Briefly distinguish between the role of management and auditors in identifying fraud and discuss the difficulties faced by the external auditors regarding detecting fraud

(5 Marks)

(Total: 25 Marks)

QUESTION THREE

You are a manager in Kamanzi & Kwizera Associates, a firm of Certified Public Accountants based in Rwanda. You have just attended a meeting with the engagement partner and a quality control department regarding the quality of the recently completed audit for Rutongo Pharmaceuticals Ltd that has a chain of pharmacies across Kigali.

The audit report on the financial statements of Rutongo Pharmaceuticals Ltd, a long-standing audit client for the year ended 31 December 2020 was issued in May 2021 and was unmodified. In June 2021, Rutongo Pharmaceuticals Ltd's audit committee contacted the audit engagement partner to discuss a fraud that had been discovered. The company's internal auditors estimate that medical drugs valued at FRW 112.5 million had been stolen by the company employees in a fraud that has been operating since June 2020.

The audit engagement partner commented that neither tests of controls nor substantive audit procedures were conducted on the inventory movement of the medical drugs during the latest audit as in the audits of the prior years the auditors had not identified deficiencies in the controls over the medical drugs held by the company.

The total assets recognized in Rutongo Pharmaceuticals Ltd's financial statements at 31 December 2020 were FRW 2,000 million. Rutongo Pharmaceuticals Ltd is considering suing Kamanzi & Kwizera Associates for the total amount equivalent to the value of the medical drugs stolen from the company, claiming that the audit firm was negligent in conducting the audit.

Required:

(a)Explain the matters that should be considered in determining the extent to which Kamanzi & Kwizera Associates can be held responsible for the fraud that occurred at Rutongo Pharmaceuticals Ltd (15 Marks)

Your audit firm is also the auditor of Gisagara Glass Mart (GGM) Limited, a company that imports and sells glass-made materials to wholesalers and retailers in Rwanda. The audit of

GGM Ltd is almost complete and you are now reviewing the other draft reports included in the integrated report that will also contain the audited financial statements. You have learnt of a new requirement in the industry sector in which GGM Ltd operates, where the regulator will now require all companies in this sector operating within Rwanda to prepare an integrated report having among others an evaluation of several Key Performance Indicators (KPIs) in addition to the audited financial statements. Consequently, your client GGM Ltd will for the first time in the year ended 30 June 2021 present its financial statements as part of an integrated report.

GGM Ltd has included several key performance indicators in the draft integrated report. One of the KPIs under "financial performance" the company has included reads in part as follows: "the directors are happy to report that the profit before tax has increased in the year ended 30 June 2021 by 25% compared to the previous year". The financial statements you have reviewed during the audit show that the profits before tax in the year ended 30 June 2021 has decreased by 10% compared to the previous year and this was mainly due to the company losing a major customer to a new competitor that started operating in Rwanda from January 2021.

Required:

(b) Describe the implications of the information provided in the scenario above on the completion of the audit of GGM Ltd and on the auditor's report recommending any further actions which should be taken by the auditor (10 Marks)

(Total: 25 Marks)

QUESTION FOUR

Your audit firm Umuhoza & Partners a firm of Certified Public Accountants based in Rwanda is the external auditor of a new client Sibomana Limited which is a listed company on the stock exchange. Sibomana Ltd is a retailer with its head office, main store and warehouse in Kigali and additional stores in 15 other cities within Rwanda. As part of the recommended corporate governance requirements from the stock market regulator, the company has established an audit committee and has developed its internal audit operation in recent years. Among the activities of the internal audit department are:

(i) The documentation and evaluation of 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 stores which include cash counts and observation of cyclical inventory counts as well as a range of tests of controls and substantive procedures in areas such as purchasing, wages records and banking

Sibomana Ltd's Chief Financial Officer (CFO) believes that the external audit fee could be significantly reduced if there was more effective coordination of work between the internal and external auditors and the elimination of un-necessary duplication. The CFO is aware of the requirements of ISA 610 Considering the Work of Internal Auditing

Required:

(a)Describe the evaluation of the internal audit function that your audit firm would need to undertake (10 Marks)

(b) Assuming the evaluation confirms the adequacy of the internal audit function, explain the extent to which your audit firm could place reliance on the work of the internal audit in the following areas:

(i) Obtaining and documenting the understanding of the accounting and internal control systems.

(ii) Performing tests of controls.

(iii) Assessing inherent and control risks.

(iv) Performing procedures requiring the use of computer assisted audit techniques (CAATs).

(v) Performing substantive tests on cash and inventory at the stores (15 Marks)

(Total: 25 Marks)

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