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**CERTIFIED PUBLIC ACCOUNTANT  
INTERMEDIATE LEVEL EXAMINATIONS**

**I1.4: AUDITING**

**DATE: FRIDAY, 27 AUGUST 2021**

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**INSTRUCTIONS:**

1. **Time Allowed: 3 hours 15 minutes** (15 minutes reading and 3 hours writing)
2. This Examination is divided into two sections (A & B)
3. Section A has **three** Compulsory Questions while Section B has **three** questions to choose **two**
4. **Five** questions in total are to be attempted

## **SECTION A**

### **QUESTION ONE**

You are the Audit manager of **Bwiza Co**, and you are currently responsible for the audit of **Mukorogo Co**, a company which develops and manufactures health and beauty products and distributes them to wholesale customers. Its draft profit before tax is **Frw 6,400,000** and total assets are **Frw 37,200,000** for the financial year ended 31 January 2019. The final audit is due to commence shortly, and the following matters have been brought to your attention:

#### **Research and development**

**Mukorogo Co** spent **Frw 1,900,000** in the current year developing nine new health and beauty products. All of which are at different stages of development. Once they meet the recognition criteria under IAS 38 Intangible assets for development expenditure, **Mukorogo Co** includes the costs incurred with intangible assets. Once production commences, intangible assets are amortised on a straight-line basis over three years. Management believes that this amortisation policy is a reasonable approximation of the assets' useful lives, as in this industry there is constant demand for innovation new products.

#### **Depreciation**

**Mukorogo Co** has a large portfolio of property plant and equipment (PPE). In March 2017, the company carried out a full review of all its PPE and updated the useful lives, residual values, depreciation rates and methods for many categories of asset. The finance director felt the changes were necessary to better reflect the use of the assets. This resulted in the depreciation charge of some assets changing significantly for this year.

#### **Bonus**

The company's board is made of seven directors. They are each entitled to a bonus based on the draft year end net assets, excluding intangible assets. Details of the bonus entitlement are included in the directors' service contracts. The bonus, which related to the 2018-year end, was paid to each director in February 2018. Separate disclosure of the bonus, by the director, is required by legislation.

#### **Required:**

- a) **Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Mukorogo Co's research and development expenditure.** (5 Marks)
- b) **Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to matters identified regarding depreciation of Property, Plant and Equipment.** (5 Marks)
- c) **Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to the directors' bonus.** (5 Marks)

During the audit, the team discovered that the intangible assets balance includes **Frw 440,000** related to one of the nine new health and beauty products development projects, which does not meet the criteria for capitalization. As this project is ongoing, the finance director has suggested that no adjustment is made in the 2018 financial statements. She is confident that the project will meet the criteria for capitalisation in 2019.

**Required:**

- d) Discuss the issues and describe the impact on the auditor's report, if any, should this issue remain unsolved?** (5 Marks)

**(Total: 20 Marks)**

**QUESTION TWO**

An independent auditor's report provides one of four opinions as a result of financial statements' audit. The opinions issued are unqualified, qualified, adverse and disclaimer of opinion. An unqualified opinion has no reservations concerning the financial statements. This is also known as a clean opinion meaning that the financial statements appear to be presented in accordance with accounting policies. The other three opinions are less favourable.

The management letter is issued together with the audit report. Often, management provides a written response to accompany the auditor's comments. The reports are important because they are submitted to outside parties for their decision making. It is also argued that external auditor is hired due to the principal and agency relationship.

**Required:**

- a) Define the term-management letter** (2 Marks)  
**b) List the 4 items that should be included in a management letter** (6 Marks)  
**c) Differentiate a management letter from an audit report** (4 Marks)  
**d) State the different users of audit report** (8 Marks)

**(Total:20 Marks)**

**QUESTION THREE**

- a. Differentiate between tests of control and substantive tests** (4 Marks)  
**b. List control objectives in respect of each of the following cycle of stock: recording, safeguarding, valuation and holding an inventory.** (6Marks)  
**c. Explain the meaning of the following terms as used in auditing:**  
i. The risk-based approach (1.5 Marks)  
ii. Systems and controls approach (1.5 Marks)  
iii. Cycles and transaction approach (1.5 Marks)  
iv. Balance Sheet approach (1 Mark)  
v. Directional testing approach (1.5 Marks)  
vi. Auditing around the computer approach (1.5 Marks)  
vii. Auditing through the computer system (1.5 Marks)

**(Total: 20 Marks)**

## **SECTION B**

### **QUESTION FOUR**

**Gumamurugo Ltd** is a government owned company created on 1 February 2018. The company supplies food stuffs and sanitary products to different customers during the period of lockdown. The company was never audited by the Office of the Auditor General of State finances (OAG) since its establishment. The net profit of **Gumamurugo Ltd** for the year ended 31 January 2021, after charging remuneration of Chief Executive Officer (CEO) **Frw 5.2 million** amounted to **Frw 990 million**. During the first audit conducted by OAG in February 2021, it was noted that the Chief Finance Officer had charged personal traveling expenses amounting to **Frw 800,000** to business expenses.

**Required:**

- a) **In respect of materiality, ISA 320 requires an auditor to consider both the quantitative and qualitative aspects of misstatement. In reference to the above case, list 5 examples of qualitative aspects of materiality** (10 Marks)
  - b) **Describe 5 roles of the Office of the Auditor General in public procurement and administration** (10 Marks)
- (Total: 20 Marks)**

### **QUESTION FIVE**

**Kimaranzara** is a charity organisation whose constitution requires that it raises funds for education projects. These projects seek to educate children and support teachers in different countries. Charities which **Kimaranzara** operates from have recently become subject to new audit and accounting regulations. Chart income consist of cash collections at fundraising events, telephone appeals and bequests (money left to the charity by deceased persons). The trustees do not consider the charity as being able to afford to employ an internal auditor (a qualified accountant). The organisation employs a part-time bookkeeper and relies on volunteers for fundraising. Your firm has been appointed as accountants and auditors to this charity because of the new regulations.

The trustees are arguing that there is no need to hire an internal auditor and further hire an external auditor as the two carry out the same tasks and bear the same liabilities. They further want to write to the regulator requesting a special exception in order to hire in an external auditor rather than hiring both, as the external auditor will have no limitation during the audit of every financial year.

**Required:**

- a) **Explain the distinctions between an internal auditor and an external auditor.** (8 Marks)
  - b) **Highlight the limitation of external audit to the trustees of Kimaranzara.** (6 Marks)
  - c) **Describe 3 rights of your audit as external auditor once hired by Kimaranzara.** (6 Marks)
- (Total: 20 Marks)**

## QUESTION SIX

**Ngunda Stores Co** operates 100 supermarkets. The company's year-end is 31 January 2021. Your audit director and partner recently attended a planning meeting with the Chief Finance Officer and have provided you with the planning notes below.

You are senior auditor, and this is your first year on this audit. In order to familiarise with **Ngunda Stores Co**, the audit director has asked you to undertake some research in order to gain an understanding of **Ngunda Stores Co**, so that you are able to assist in the planning process. She has then asked you to identify relevant audit risk from the notes below and also consider how the team should respond to those risks.

**Ngunda Stores Co** spent **Frw 1,600,000** in refurbishing all of its supermarket; as part of refurbishment programme, their central warehouse located at Ntenyo sector has been extended and a smaller warehouse which was occasionally used has been disposed of at a profit in period of the lockdown. In order to finance this refurbishment, a sum of **Frw 1,500,000** was borrowed from the bank via the program of Covid-19 recovery Funds. This is due to be paid over five years.

The company will be performing a year-end inventory count at a central warehouse as well as at all 100 supermarkets on 31 January. Inventory is valued at selling price less an average profit margin, as the Chief Finance Officer believes that this a close approximation to cost.

Prior to 2021, each of the supermarket maintained their financials, recorded and submitted monthly returns to the head office. During 2021 all accounting records have been centralised at the head office. Therefore, due to Covid-19 prevention measures and lockdowns, at the beginning of the year, each supermarket's opening balances were transferred into head office's accounting records. The increased workload at the head office has led to some changes in the finance department and in December 2020 the financial controller left. His replacement will start late in May 2021.

The Chief Finance Officer is also thinking about computerising all the business. As part of his idea, he is planning the creation of an online web-based sales ordering for customers to purchase products using personal credit cards for payments.

### **Required:**

- a) **List five sources of information that would be of use in gaining an understanding of Ngunda Stores Co and for each source describe what you would expect to obtain.**  
(8 Marks)
- b) **State any six audit procedures you would perform on opening balances of Ngunda Stores Co.**  
(6 Marks)
- c) **Identify three risks related to an online sales system that the Chief Finance Officer should consider. Identify internal controls that could be implemented to reduce those risks.**  
(6 Marks)

**(Total: 20 Marks)**

**End of question paper**