



CERTIFIED PUBLIC ACCOUNTANT
ADVANCED LEVEL 1 EXAMINATIONS
A1.2: AUDIT PRACTICE AND ASSURANCE SERVICES

DATE: FRIDAY, 03 DECEMBER 2021

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

Tripartite Bank of Rwanda Limited (TBR Ltd) is a registered bank in Rwanda and operates under Law No 47/2017 of 23 September 2017 governing the organization of Banks. It prepares its financial statements in accordance with article 123 Law No 17/2018 of 13 April 2018 Governing companies in Rwanda. It started its operations in 1982 in the Southern Province, Mugambwa Sector, Kibayi Village when it was launched as a savings and credit schemes to the population living in the neighbourhood. It started operations with a very small customer base but kept on growing in number and shareholders as people's lives were improving.

Like any other business operating in the country by then, the bank suffered significantly from the Genocide against the Tutsi in 1994, whereby almost 70% of its staff died, their assets stolen, and buildings destroyed. A few of the surviving shareholders decided to resuscitate the bank by pooling their resources to resume the lending activities.

By the time the bank was resuscitating, its reputational risk was too low, Non-performing Loans (NPL's) ratio were approximately 100%, Liquidity ratio close to nothing (below 5%) and their financing was majorly dependent on outside borrowings. However, its operations took shape after almost 5 years, and it is currently one of the prime commercial banks in the country with credible banking services.

In 2009, the National Bank of Rwanda allowed TBR Ltd to start its operations as a commercial bank with wider networks in the country. Due to its well-established management, and significant improvement in the previously renown reputation risk, they attracted foreign investors which saw Dahab Investment Bank (DIB Limited) from Arabs, on 13 March 2013, acquire 62.23% of its shareholding to merge with the total assets acquired in Terintambwe Credit and Savings Cooperative (TCSC) acquired in 2011 to be 72.23% of shareholding. Currently, TBR Plc counts more than 90 branches in Rwanda and 105 ATM locations with introduced Agency banking.

With reference to the requirements of the statutory regulations of Banks set by the National Bank of Rwanda (NBR), that Banks should appoint independent auditors to report on its statement of financial position as at the balance sheet date, statement of comprehensive income and statement of cash flows for the year then ended, TBR Plc appointed "Perfect Financial Advisors (PFA)" as new auditors which you work for as an engagement associate director to discharge the auditor's responsibilities to NBR for the year ended 31 December 2020.

As an auditor of a financial institution, the National Bank of Rwanda requires you to report to them if, in the course of your work, you identify:

- ✓ Any events that jeopardize the interests of the bank, its depositors, and other creditors
- ✓ Any events or conditions that may affect the Company's ability to continue as a going concern
- ✓ A serious breach or non-compliance with Law No. 47/2017 of 23/09/2017 Governing the Organization of Banking, Law. No. 69/2018 of 31/08/2018 on prevention and punishment of money laundering and terrorism financing, Law No. 48/2017 of 23/09/2017 governing the National Bank of Rwanda and other regulations issued by the National Bank of Rwanda, or a material breach of the TBR Ltd.'s policies or Memorandum and Articles of

Association; whether a criminal offence involving fraud or other dishonesty has been committed by TBR Ltd or any of its officers or employees

- ✓ Any significant weaknesses in the Company's internal control which may render it vulnerable to significant risks or exposures that have potential to jeopardize its financial viability; and
- ✓ Material adverse changes in current or potential risks to the Company's business

As part of preparation for the audit, the below extract of the financial information was shared with the audit team, however it does not provide plentiful details of the financial status of the bank:

| Financial Statement Line Item | 31 December 2020 | 31 December 2019 | Percentage movement |
|--------------------------------------|-------------------------|-------------------------|----------------------------|
| Assets (Extract) | FRW'000 | FRW'000 | |
| Investment in Eurobond securities | 37,374,608 | 76,071,407 | (51%) |
| Loans and advances | 91,709,449 | 162,740,904 | (44%) |
| Property, Plant and equipment | 21,632,329 | 10,202,499 | 112% |
| Inventories | 5,090,312 | 7,245,678 | (30%) |
| | | | |
| Liabilities (Extract) | | | |
| Deposit from customers | 124,302,736 | 172,384,917 | -28% |
| Other payables | 21,781,109 | 12,187,412 | 79% |
| Legal claims payable | 763,180 | 1,624,053 | -53% |
| Lease Liability | 50,592,000 | 63,500,000 | -20% |
| | | | |
| Interest income | 34,273,828 | 12,996,567 | 164% |
| Interest expense | 7,082,436 | 6,772,921 | 5% |
| Net fee and commission income | (904,124) | (1,127,422) | (20%) |

Additional information

(i) There has been trending news that the bank is yet to be taken over by another big brand Investment company; Achilles Investment Group (AIG Limited), which reiterated to the auditors "Perfect Financial Advisors" (PFA) the need for a rigorous audit and provide audit opinion on the extended financial information available to them. This was due to the circulating rumours that the bank's management inflated the performance results of the bank as their bonuses are paid on the basis of how the bank performs.

(ii) In addition to the above, the bank's legal claims as at year ended 31 December 2020 did not include a potential claim that would result in a loss of 1billion Rwandan Francs. This was lodged against the bank in relation to a performance guarantee issued to a construction company which had won a tender of putting up a strong bridge over Nyabarongo river and failed to complete the project. The project cost was FRW 1.3billion and only activities amounting to FRW 300million had been completed as at the time the construction company stopped their operations and from the first court hearing, it is imminent that the bank is liable for non-completion of the construction of the bridge.

(iii) It should be noted that the bank charges loan disbursement fees up front on customers who borrow money from the bank. The above loan disbursement fees charged on customers have been fully recognized under interest income with no deferral made. The issued loans to customers are on an average tenor of 5 years and the total fees charged on loans during the year amount to FRW 1.7 billion

(iv) There has been no purchase of property, plant and equipment during the year and the depreciation for the period amount to FRW 6 billion.

(v) The audit performance materiality is FRW 150 million.

Required:

a) Considering that there is a lot going on in the bank; information available from different sources (external environment) highlights potential risks that the bank faces and that this is your first year of audit (initial engagement),

Explain how you would acquire reasonable comfort that you possess normal understanding of Tripartite Bank of Rwanda Ltd (TBR Ltd) to be able to carry your audit for the year ended 31 December 2020 and issue an audit opinion backed by the proper knowledge of the entity. (10 Marks)

b) With reference to the above passage on Tripartite Bank of Rwanda (Plc), and the extract of the financial statements, there is a potential risk of material misstatement in several financial statement line items.

Give examples of which line items that present such a risk as shown by the extract above and explain the rationale of the susceptibility of risk. (5 Marks)

c) Referring to the answers given under sub-question (b) and the general understanding of conditions and events that might indicate risks of material misstatement. **Provide explanation/examples of such conditions/events.** (5 Marks)

d) International Standards on Auditing are believed to be professional standards which set a benchmark of how auditing of financial information should be conducted. There are audit tests and procedures which should be applied on items of the financial statements to ensure that they are accurately reported, complete, appropriately presented and disclosed, etc.

The standard recognises that auditors will not ordinarily test all the information available to them because this would be impractical as well as uneconomical.

(i) Since these tests cannot be applied on all the information in full, **what is the right term used referring to not applying those tests on all the information available to the auditor.** (1 mark)

(ii) **Which audit standard sets the audit technique in (i) as an audit technique to achieve the desired level of assurance?** (1 mark)

(iii) Explain the meaning of the above technique stated in (i) in accordance with the International Standard on Auditing mentioned under (ii) above with a vivid example with reference to Tripartite Bank of Rwanda Ltd. (2 Marks)

(iv) Indicate 1 advantage of using the above technique in audit. (1 Mark)

(v) Explain the risk associated with using the above audit technique highlighted. (2 Marks)

(vi) Give one example of a method used in applying the above technique. (1 Mark)

e) The International Standards on Auditing (ISAs) are auditing guidelines developed by the IAASB. These are international standards devised to align auditing around the globe. While not all countries require compliance with the ISAs, most at least use the standards as a guide for their own home-brewed systems. International standards are meant to shed more light on what is expected of an auditor on a given financial information and what his responsibilities to the users of financial information are.

(i) If Dahab Investment Bank (DIB Limited) bought shares in another microfinance ZY Plc operating in Kenya with an acquisition of 54%,
which International Standards on Auditing would govern you “Perfect Financial Advisors (PFA)” in as far as the affiliation of TBR Ltd and ZY Ltd is concerned?

(2 Marks)

(ii) How best would you technically define the status of affiliation existing between TBR Ltd and ZY Ltd in accordance with the provisions of the International Standards on Auditing stated under (i). (2 Marks)

(iii) In all circumstances, an auditor, in reference to International Standards on Auditing (ISA) under (i) above, is required to analyse and understand the affiliations existing between entities and the one that he is auditing and transactions existing amongst them. This is because the ISA assumes some risks in that, hence the auditor should be keen on how the above transactions arise.

Enlighten 2 reasons which would explain why such risks are assumed in the above highlighted transactions. (2 Marks)

(iv) Since the auditor is supposed to obtain representations from the management, and where applicable, those charged with governance on such transactions as highlighted under (i), (ii) and (iii) above. **State two aspects that you, as an auditor, would want to obtain representations from the management/board of directors on such transactions. (2 Marks)**

f) In accordance with the provisions of the IFRS 9 on financial instruments which requires entities to assess the expected credit loss on its financial assets, the management of TBR Plc understood the importance of complying with the standards on their financial statements, but because the bank did not have expertise in how to develop the model and the whole process of incorporation required inputs in the model, they hired “Learn & Lead” company, which is a duly registered company under laws governing companies in Rwanda, to develop the model for them. $ECL = EAD \times PD \times LGD$, they are expanded below:

ECL: Expected Credit Loss

EAD: Exposure At Default

PD: Probability of Default

LGD: Loss Given Default

International Standards on Auditing (ISA) 500, "Audit Evidence" confirms that if the information to be used as evidence has been prepared using the work of a management's expert, then the auditor should satisfy himself on how much reliance he should place on the submitted piece of work.

(i) Define who an auditor's expert is in accordance with the International Standards on Auditing. (2 Marks)

(ii) With reference to the above, what should you, as an auditor of TBR Ltd who has been shared the IFRS 9 output by the management, do to obtain reasonable assurance that the work submitted by the expert can be relied upon? (3 Marks)

(iii) Design and explain robust possible audit procedures that you would carry out on the work of experts to gain comfort over it. (3 Marks)

g) Tripartite Bank Ltd's core banking system started developing technical problems which would at times impede the finance team from doing the financial reporting on time, and on top of the above, there are some numbers in the financial statements which would not be accurately spooled due to some malfunctioning of the system. Due to the above, TBR Ltd decided to engage an IT expert who was tasked to develop a new system which would replace the existing one. The bank spent FRW 1.7 billion on the project during the year and they have capitalized the whole amount an intangible asset.

(i) State the International Financial Reporting Standards governing the treatment of Intangible assets. (1 Mark)

(ii) Discuss the specific requirements that the above International Financial Reporting Standards set out in relation to capitalisation of development costs. (2 Marks)

(iii) With reference to the above capitalized costs, as an auditor, what is the risk in what could be included in the financial statements? (1 Mark)

(iv) After having established the above risk under (iii) above, what would be the impact on the financial statements if this was the case? (1 Mark)

(v) What would be the best tests to apply to development costs to find out if its treatment meets the provisions of the standard under (i) above? (1 Mark)

(Total :50 Marks)

SECTION B

QUESTION TWO

Duhange Master of Architect Company (DMAC Limited) was registered with RDB on 1 April 2012. It deals with construction of roads, bridges, and carries out other utility projects and civil engineering projects. During the year 2020, the company reported huge losses amounting to FRW 12 billion and it was in a net liability position of FRW 6 billion.

The company complies with Law No. 17/2018 of 13/04/2018 Governing Companies in Rwanda in preparing its financial statements. The above law clearly sets out the responsibilities of directors in relation to preparation of financial statements for each financial year.

As a statutory requirement which applies on big companies making huge revenues, they are required to appoint an external auditor who provides assurance to external users that the published financials are true and fair.

Required:

a) (i) Assuming that you are the engagement leader for an audit firm that was engaged to provide assurance services to Duhange Master of Architect Company (DMAC Limited), **what advise will you provide to the board of directors with respect to preparation and issue of financial statements?** (4 Marks)

(ii) **Explain the auditors' responsibilities regarding the auditing of financial statements of a company.** (6 Marks)

b) With reference to the information provided above on the performance of Duhange Master of Architect Company (DMAC Limited) and as an engagement leader for the assignment.

(i) **What is the role of emphasis of matter paragraph on audit report** (3 Marks)

(ii) **Explain two circumstances under which an auditor may choose not to issue an unmodified opinion** (2 Marks)

(iii) Depending on how bad the results of their audit tests come out, auditors have dissimilar forms they use to express their conclusions on the audit matter that came to their attention. **Briefly explain the forms of qualification** (6 Marks)

(iv) **Clearly explain using an example the meaning of the term "pervasiveness" as used in audit opinion.** (2 Marks)

(v) **What does the term "other matters" as used in audit report mean?** (2 Marks)

(Total :25 Marks)

QUESTION THREE

a) You have been entrusted to lead an audit engagement. In the course of your system audit performed by your Risk Assurance Service, you identified that peat production rates set in the system are different from rates reviewed and signed by the production manager in charge of approving such rates before inputting in the system. The loss sustained by their customers in the financial year ended 28 February 2020 was pervasive to the financial statements and the customers had not discovered that the losses that they were incurring were due to system errors of their supplier whose controls were not operating effectively. In addition, the audit committee were not aware of what was going on in the company. After analysing the prevailing situation, the company appointed forensic auditors who later on noted that there was a collusion of the system administrator and the finance manager to inflate their costs so that the company could not pay taxes, and this has always been the case for the last 5 years. The revelation of that case was assessed by management as a dent to their image and feared that it would adversely affect them through loss of customers to their competitors. The audit team through their Risk assurance services reported the issue but the management refused to communicate to the board as it would result in dismissal of a number of them. You performed additional inquiries with other staff members that are not considered key management personnel outside finance and IT department and came to a conclusion that the system manipulation of production rates was a deliberate act done by the IT manager who had super-user system rights to perform certain functions without requiring other people's approval. You presented your findings to the engagement partner and told him about the management's proposal to not present it to the board and your partner opposed the idea since it would tarnish the firm's image and it would be against the ethical behavior that should characterize professional firms.

Due to ineffectiveness of controls, the IT manager and the finance manager would procure office supplies at low costs, but they end up manipulating numbers in the system to record high costs and the difference is confiscated.

Your engagement partner also added that in your next year audit, you should pay much attention to system settings especially by checking if rates as per system match what has been approved by the responsible manager and that another level of control be added to exercise an oversight over activities done by super users on the system.

Required:

- (i) **With reference to the above passage, differentiate a fraud from an error.** (2 Marks)
- (ii) **With examples of cases noted in the above passage above, explain the two types of misstatement that such cases can result into.** (2 Marks)
- (iii) **Highlight which auditor's responses need to be designed to respond the risk of material misstatement due to fraud in relation to the above passage?** (4 Marks)
- (iv) **Is an auditor responsible for the prevention and detection of Fraud? Explain your answer giving reference to the above passage.** (2 Marks)

b) Being an audit manager at “Save Your Career Consult Rwanda Ltd”, a professional firm providing assurance services to both public and private companies in East Africa, including advisory services. Save tomorrow today Limited, a credit and savings microfinance has approached you to offer advisory services over its financial statements which they suspect might have been misstated due to fraud. The company has had several cases of fraud in the past and there is increased desire from the management to clear out the bad reputation. The audit services are expected to be completed in one month time from the engagement signing date which is 11 February 2021. The company is required to complete the audit and submit its audited financials to Rwanda Revenue Authority not later than 31 March 2021. Any delay attracts heavy penalties and management is cautious cannot afford paying.

Required:

- (i) **As an auditor of a company that holds a history of fraud cases, which steps would you take to ensure that you avoid being held liable for a breach of negligence in arriving at audit conclusion?** (8 Marks)
- (ii) **Given the fact that the entity has historically been depicted as fraud prone, which the management is working towards eradicating. Design the procedures which your audit firm needs to adhere to gain information deemed reasonable to conclude on the assessment of risk of fraud.** (7 Marks)

(Total :25 Marks)

QUESTION FOUR

Companies operating in Rwanda and registered with the Rwanda Development Board are required to register the directors of the company together with other company’s information. The Future Limited is an agricultural company dealing in the production of Chili pepper which is in high demand at the international market. The company has a paid-up share capital of FRW 35 million, 5 shareholders with 5,833.33 shares each at a nominal value of FRW 1,000 per share. 10 December 2020 marked their 5-year anniversary of operations; however, all those years were significantly denoted by heavy losses with accumulated losses amounting to FRW 25.6 million. The way the business is run is quite messy with one Managing Director (MD) who does not report to anyone except having oral discussions with the shareholders whenever they come for field visit and the finance team which reports to the MD, but they also work under his influence in discharging their responsibilities. The use of the business cash is not the best. Despite the fact that the company has been in operation for 5 years, management is still unfamiliar with the agriculture industry hence they hired an agronomist who follows up on their agricultural activities on daily basis and shares her report for review. They are currently struggling to raise enough liquidity to keep up their operating activities. As of 31 December 2020, they hired an external audit firm services which run through their books and review of their internal controls, and the audit report which was issued was nowhere near the desired one and this was as expected due to poor skills in how the business is managed.

In the audit report, the auditor highlighted key audit issues that would result in the shutdown of the business in case nothing is done. He identified huge payments on the bank statements which are not properly supported by genuine documents, personal expenses being paid out of the company's resources, and several controls not working effectively. After the clearance meeting in which the above issues, the Managing Director concurred with the auditor on the findings which resulted in his dismissal from a unanimous decision of all the shareholders.

However, the auditor informed the shareholders that the issues covered in the report cannot only be resolved by a change in the management, but rather there is a need to appoint an audit committee to which the newly hired management will be reporting to on a monthly basis so as to solve the problems as early as they arise. 3 shareholders of the company do not have a strong background in finance, neither have they had an experience of working with audit committees before and they did not understand the essence of appointing directors as it would result in cash outflows paid to them in form of board sitting allowances. As the company's rules state that a decision would be taken if 3 out of 5 shareholders voted for it, the other 2 shareholders approached you for convincing points they would be presented to the rest of the shareholders to support the idea of appointing the audit committee.

Required:

a) From your review of the above passage and as a student of audit and assurance course, other information provided that you gathered from different learning materials,

Identify and explain the key role that the above audit committee will serve to turn around the performance of the future Limited. (6 Marks)

b) After looking at how important the audit report shared by the external auditor helped the shareholders revive the operations of the company, the audit committee led the thought process of creating an internal audit department which would help the audit committee in discharging their roles and be able to deliver quality output while helping the entity achieving the business goals.

Prepare a note stating all significant undertakings that the audit committee should prioritize to ease the work of internal audit. (6 Marks)

c) Consideration of laws and regulations that an entity operates in should be given the highest attention it deserves by auditors; this is because there are so many implications which the non-compliance would have on the entity's performance and existence. As any other significant area of concern that auditors need to pay attention to, the International Accounting Standards Board set out an Auditing standard to cover the required aspects in relation to laws and regulations.

(i) Which International Standard on Auditing governs the above consideration on laws and regulations in and audit of financial statements? (1 Mark)

(ii) You have been approached as an expert in auditing, to the required considerations of an auditor regarding the laws and regulations as per the standard above in (a).

Provide the reflection of what the standard stated above defines as an act of non-compliance. (2 Marks)

d) Identify and clarify the obligatory deliberations of the auditor towards obtaining comfort over the company's compliance with laws and regulations. (5 Marks)

e) The National Bank of Rwanda serves as the overall regulator for all banks operating in Rwanda and the non-compliance with their regulations/laws/guidelines result in heavy fines and penalties which would go as far as revoking the accreditation for operations in case the non-compliance has gone overboard. Recently, one bank received a visit from an authority during the year who discovered incorrect levels of Expected Credit Loss (ECL) provisions for their financial assets together with inaccuracies in their financial reporting pack. This was due to the legacy problems arising from the upgrade of their core banking system which had not captured the correct staging of loans and the migrated numbers from the old system from prior years. The finance director questioned the audit firm as to why they had not identified this non-compliance with legislations, and they issued a letter to them asking for explanation of why they showed such incompetent, yet they had been hired as professionals who would prevent such instances.

(i) If you were part of the engagement team and you were asked to provide a letter responding to the angered finance director who appears to put the blame on the audit team in regard to the non-compliance highlighted above. **What are the likely responses you would incorporate in the letter reiterating their responsibility in that regard?** (3 Marks)

(ii) Bearing in mind on the above responsibilities of directors and auditors in response to non-compliance with laws and regulations, **Design audit procedures that you would apply as an auditor to give you reasonable assurance that there is no non-compliance case within the entity that would result into material misstatements in the financial statements.**

(2 Marks)

(Total :25 Marks)

End of Question Paper

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