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**CERTIFIED PUBLIC ACCOUNTANT  
ADVANCED LEVEL 1 EXAMINATIONS**

**A1.2: AUDIT PRACTICE AND ASSURANCE  
SERVICES**

**DATE: TUESDAY, 27 APRIL 2021**

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**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.

## **SECTION A**

### **QUESTION ONE**

a) Broadways Confectionery Ltd (BCL) specialises in the manufacture of bread and biscuits. It competes with four other bakeries. The audited financial statements for the year ended 31 May 2020 revealed a profit of Frw 500 million down from Frw 1.123 billion in 2019, while the total assets were Frw 6.236 billion. In order to expand its operations, the company purchased Prime Bank Ltd at a consideration of Frw 5 billion. The net assets of Prime Bank Ltd were Frw 3 billion. The purchase was partly financed through a loan of Frw 4.5 billion from Njoba Bank Ltd and the balance from retained earnings. Prime Bank Ltd uses a similar financial accounting date and accounting framework like BCL.

Prime Bank Ltd had also recently acquired a banking software to do internet banking. The staff had failed to operate the system effectively due to inadequate training while customers could not access their accounts using the software over the internet. There was also a high credit default rate by BCL of Frw 1.8 billion which amounts to about 7.8 % of the total assets. It was also facing cashflow problems as it could not effectively service its loans and meeting its current obligations. Furthermore, the earnings of the bank have been graded poor by the National Bank of Rwanda. To compound matters, the National Bank of Rwanda has formally communicated to its potential takeover of Prime Bank Ltd's administration and operations to safeguard the bank customers' deposits.

One of BCL major customers had switched to another supplier because the customer was supplied with sub-standard products at exorbitant prices compared to better quality products offered by competitors. In order to expand the bakery business, BCL had placed orders for more machinery at a cost of Frw 800 million. The company, however, was not sure whether this machinery would be received and operational by year end. The company had spent an estimated Frw 250 million on servicing its existing machinery. In order to fund the expansion, BCL Ltd applied for additional loan of Frw 1 billion from Njoba Bank Ltd. By 31 May, there was no reply from Njoba Bank Ltd with respect to the additional loan considering that they had just borrowed from the same bank to takeover Prime Bank Ltd.

BCL Ltd receives bookings for bakery products through its agents and from its new website. The agents are normally given a 60-day credit period to pay BCL, but because of difficult trading conditions, a number of agents were struggling to meet their obligations. The website was launched in July 2019 but had consistently encountered difficulties with customers complaining that orders made and paid for online were not correctly captured by BCL, and that customers had not received their products, which allegedly had been supplied to other customers.

BCL has in the past years sold its products at one of its largest outlets in Nyamirambo, but this outlet was closed in April 2020 making a large workforce redundant.

You are the senior manager at KIT and Co. Certified Public Accountants who is in charge of the audit of BCL and its subsidiary Prime Bank Ltd for the year ended 31 May 2020. Both BCL and its subsidiary Prime Bank Ltd are KIT and CO new audit clients.

**Required:**

- (a) Identify and explain the business risks in the audit of BCL for the year ended 31 May 2020 including the risks that are facing Prime Bank Ltd. (20 Marks)**
  - (b) During your planning meeting for the audit, you were asked, using the information provided, to describe five financial statements risks and to explain the work that the auditor will need to perform to respond to each risk. (10 Marks)**
  - (c) The Senior Manager has also told you that you are responsible for the audit planning of the financial statements of BCL Ltd for the year ended 31 May 2020. Describe the factors that you will consider in planning for the audit so that it is performed in an effective manner. (10 Marks)**
  - (d) Explain the factors, with examples where appropriate, that the auditor should consider when deciding whether to use analytical procedures as substantive procedures. (10 Marks)**
- (Total 50 Marks)**

## **SECTION B**

### **QUESTION TWO**

a) You are the partner in charge of quality control review of your firm. The audit of Bugesera Investment Ltd (BIL) which floated its shares on the Rwanda Stock Exchange (RSE) three years ago is almost complete and you are now handling the audit report for the year ended 31 May 2020. With the recent hard economic times, the company underwent a lot of restructuring by closing three shops in Masaka, Muhanga and Musanze. The extract of the proposed draft auditor's report is as follows:

***Adverse opinion: Basis of adverse opinion: Disagreement due to application of IAS 37: "Provisions, Contingent Liability and Contingent Assets"***

The directors have not recognised a provision in relation to the legal fees plus redundancy costs for a suit brought about by staff that were laid off and not compensated. The reason is that the Directors do not feel that a reliable estimate of the amount can be made and so the recognition criteria under IAS 37 has not been met.

We feel that the estimate can be made as it has been fully explained in the notes to the financial position. We feel that it is a material misstatement as profit for the year is overstated.

In our opinion, the financial statements do not show a true and fair view of the financial position of the company as at 31 May 2020 and its financial performance and its cash flow for the year ended in accordance with International Financial Reporting Standards.

***Emphasis of matter paragraph***

*The directors have decided not to disclose the earning per share for 2020 as they feel that the figure could materially be distorted by significant discontinued operations in the year. Our opinion is not qualified on this matter.*

**Required:**

- (i) Critically appraise the proposed audit report of BIL for the year ended 31 May 2020. Note: you are not required to redraft the extracts from the audit report.** (9Marks)
  - (ii) Explain the matters to be considered in deciding who is eligible to perform an engagement quality control review for a listed client like BIL.** (4 Marks)
- b) A Senior Manager of your firm has been approached by the Chief Finance Officer (CFO) of BIL to investigate a fraud. The CFO had identified a number of discrepancies between the inventory records and the monthly physical inventory count which were performed. His suspicion had been escalated by the fact that discrepancies relate to the same production line unit and approximately the same quantities and item descriptions of items appear to be missing each time.

**Required:**

- (i) **Explain the procedures you would perform to determine whether a fraud has taken place and quantify the loss** (8 Marks)
  - (ii) **Many forensic investigations involve investigating potential fraud. Outline the objectives of a fraud investigation** (4 Marks)
- (Total 25 Marks)**

**QUESTION THREE**

- a) Your client, Ruli Dairy Company Ltd (RDCL), processes milk cheese and other interrelated products. The company makes emphasis on natural elements of the products and the fact that they do not contain any artificial preservatives. During the year 2020, the directors decided that it would benefit the company's public image to produce a social and environmental report as part of their annual report. There are three key assertions which they wish to make as part of their report:
- (i) Goods / ingredients of products for sale at RDCL have not been tested on animals.
  - (ii) None of the RDCLs suppliers use child's labour which is against the Rwandan and international labour laws.
  - (iii) All RDCLs packaging uses recycled materials

The directors have asked the audit engagement partner whether the firm would be able to produce a verification report in relation to the social and environmental report.

**Required:**

- i) **Identify and explain the matters the audit engagement partner should consider in relation to whether the firm can accept the engagement to report on the social and environment report.** (9 Marks)
  - ii) **Comment on the matters to consider and the evidence to seek in relation to three assertions.** (6 Marks)
- b) You are the Audit Senior of Kando Associates, Certified Public Accountants. As part of your audit assignment exercise you are required to carry out substantive audit procedures on the social or environmental issues of the financial statements when designing audit procedures.

**Required:**

- (i) **Describe the key issues that the auditor would consider when undertaking the substantive procedures as highlighted above.** (6 Marks)
  - (ii) **Briefly explain the contents of an assurance report on environmental issues.** (4 Marks)
- (Total 25 Marks)**

## QUESTION FOUR

a) You are auditing the financial statements of Mawawe Growers Ltd (MGL) for the year ended 31 May 2020. The partner in charge of audit has entrusted you to carry out a review of the company's activities since the financial year end. Mr Tushabe, the Managing Director happens to get a copy of an e-mail to that effect and is surprised that you are examining accounting information that relates to the next accounting period. Mr. Tushabe had been appointed on 1 December 2019 and the contract of the previous Managing Director Mr. Babare was terminated and was paid a compensation package of Frw 250 Million on 2 December 2019. As a result of your investigations, you found out that the company is planning to commence a legal proceeding against Mr Babare for recovery of the payment of Frw 250 Million. It has come to light that, 3 months before his dismissal he had contractually agreed to join the Board of Directors of Kayonza Grain Millers Ltd, a rival company. The company lawyer had informed MGL that Mr Babare's action constituted a breach of his contract and an action can be brought against him for recovery of the compensation money.

### Required:

- (i) **Explain the nature and purpose of a subsequent events review.** (4 Marks)
- (ii) **Describe the audit procedures which would be carried out in order to identify any material subsequent events.** (8 Marks)
- (iii) **Discuss the audit implications of the company's decision to sue Mr. Babare for the recovery of the compensation paid to him.** (6Marks)

b) Auditors have no obligations to perform procedures or make enquiries regarding the financial statements after they have been issued. However, after the financial statements have been issued and the auditor becomes aware of the fact, that had been known to the auditor at the date of the auditor's report, the auditor would have amended the audit report.

### Required:

- (i) **Outline the procedures that the auditor would perform in the given scenario above.** (3 Marks)
- (ii) **Highlight the appropriate procedures which the auditor should undertake when management revises the financial statements.** (3 Marks)

**(Total 25 Marks)**

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