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THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

06204 - Audit and Assurance

Certificate in Accounting and Business II Examination
March 2013

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

Answer No. 01

- a.
- i. Enhance the credibility of information
 - ii. Reduce the risk of management biasness
 - iii. Draws the attention of the user to any deficiencies in the information being reported on
- (3 marks)
- b.
- i. Requirements of any legislation or regulation under which the engagement is conducted
 - ii. The terms and conditions of engagement
 - iii. Ethical and professional standards
 - iv. Quality control standards
 - v. Internal regulations and internal control procedures
- (4 marks)
- c. To reduce the risk of;
- i. overlooking suspicious circumstances.
 - ii. over generalizing when drawing conclusions from observations
 - iii. using faulty assumptions in determining the nature, timing and extent of the audit procedures and evaluating the results
- (2 marks)
- d. In a reasonable assurance engagement, the practitioner expresses the conclusion in the positive form, e.g. in our opinion the financial statements give a true and fair view of the financial position
- In a limited assurance engagement the practitioner express the conclusion in negative form, i.e. based on our work nothing has come to our attention that causes us to believe that the accompany financial statements do not give a true and fair view.
- (4 marks)
- e.
- i. Use of selective testing.
 - ii. Inherent limitations of internal control
 - iii. Audit evidence is more persuasive than conclusive
 - iv. Reliance on the information provided by the responsible party
 - v. High involvement of judgment
 - vi. Involvement of estimates
- (4 marks)
- f.
- i. Determining whether the prior period's closing balances have been correctly b/f to current period.
 - ii. Determining whether the opening balances reflect the application of appropriate accounting policies.
 - iii. Performing one or more of the following:
 - Where the prior year financial statements were audited, reviewing, the predecessor auditor's working papers to obtain evidence regarding the opening balances (it is important to follow the relevant ethical and professional requirements when communicating with the predecessor auditor)
 - Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
 - Performing specific audit procedures to obtain evidence regarding opening balances.
- (3 marks)
- (Total 20 marks)

Answer No. 02

(a) (i) Documents and communication of audit committees would include a clear picture on the duties of management and the external practitioner. It is also important that the governance practices of an organisation to have proper communications with the stakeholders in educating them on the roles and responsibilities of each party while ensuring transparency.

(3 marks)

- (ii) - The objective of the engagement
- Responsibilities of each party involved in the engagement
- Scope of the engagement
- The fact that due to the inherent limitations of audit and inherent limitations of internal controls there is an unavoidable risk that some material misstatements may not be detected even though the audit was properly planned and performed as per SLAuS.

(3 marks)

(iii) Factors to be considered:

1. Any indication that the entity misunderstands the objective and scope of the audit.
2. Any revised or special terms of the audit engagement.
3. A recent change in senior management
4. A significant change in ownership.
5. A significant change in nature or size of the entity's business.
6. Change in legal or regulatory requirements.
7. A change in the financial reporting framework adopted in the preparation of financial statements.
8. A change in other reporting requirements.

(3 marks)

(b) (i) **Events occurring up to the date of the auditor's report**

- ❖ Reviewing procedures that have been established by management to ensure that subsequent events are identified.
- ❖ Reading minutes of the meetings of shareholders, those charged with governance, including established committees such as relevant executive committees and the audit committee, held after period end and inquiring any matters discussed at meetings for which minutes are not yet available.
- ❖ Reading the entity's latest subsequent interim financial statements and as considered necessary and appropriate, budgets, cash flow forecasts and other related management reports for periods after the date of the financial statements.
- ❖ Inquiring or extending previous oral or written inquiries of the entity's legal counsel concerning litigation and claims.
- ❖ Inquiring of management as to whether any subsequent events have occurred which might affect the financial statements
- ❖ Examples of inquiries of management on specific matters are:
 - ◆ The current status of items that are accounted for on the basis of preliminary or inconclusive data.
 - ◆ Whether new commitments, borrowings or guarantees have been entered into.
 - ◆ Whether sales or acquisition of assets have occurred or are planned.
 - ◆ Whether the issue of new shares or debentures or an agreement to merge or liquidate has been made or is planned.
 - ◆ Whether any assets have been appropriated by the government or destroyed, for example, by fire or flood.
 - ◆ Whether there have been any developments regarding contingencies.

- ♦ Whether any unusual accounting adjustments have been made or are contemplated.
- ♦ Whether any events have occurred or are likely to occur which will bring into question the appropriateness of accounting policies used in the financial statements as would be the case, for example, if such events call into question the validity of the going concern assumption.

(3 marks)

(ii) **Accounting estimate:**

1. Review and test the process used by management to develop the estimate;
2. Use an independent estimate for comparison with that prepared by management;
3. Review of subsequent events which provide audit evidence of the reasonableness of the estimate made.

(3 marks)

- (c)
1. Current Liabilities are in excess of Current Assets.
 2. The loss for the year will wipe out the retained earnings balance.
 3. The loan repayments have not been made, the terms and conditions of the loan covenants may have been breached.
 4. Loss of key sales personnel.
 5. Loss of key customer.

(4 marks)

- (d)
- Inquire and understand how the expert is satisfied that the source data are relevant and reliable
 - Verifying the origin of the data including obtaining an understanding of and where applicable testing the internal controls over data and where relevant its transmission to the expert.
 - Reviewing the data for completeness and internal consistency.
 - If the expert has tested the source data inquiring of that expert by the auditor or supervision or review of expert's tests may be appropriate to evaluate that data's relevance, competences and accuracy.

(4 marks)

- (e)
1. Comparable information of prior periods.
 2. Anticipated results of the entity, such as budgets or forecasts or expectations of the auditor, such as an estimation of depreciation.
 3. Similar industry information – e.g. ratio of sales to accounts receivable.
 4. Consideration of relationships among elements of financial information.
 5. Consideration of relationships between financial information and relevant non-financial information e.g. payroll costs to number of employees.

(2 marks)

Answer No. 03

- (a) Since Mr. George was in-charge of the SLFRS implementation at Pubudu Enterprises, there will be a threat of him reviewing his own work since this is the 1st financial year after implementing SLFRS. Accordingly, Mr. George is not independent with respect to Pubudu Enterprises due to self-review threat.
(4 marks)
- (b) Since Mr. John had been working at ABC PLC, he will be familiar with the systems and controls of the entity and will be reviewing his own work and that will impair his independence towards ABC PLC due to familiarity threat/self review threat
(3 marks)
- (c) When Mr. Dick's investments are at Big Money Finance PLC, he will have an interest towards the performance of the entity. Therefore, Mr. Dick is not independent with respect to Big Money Finance PLC due to self-interest threat.
(3 marks)
(Total 10 marks)

Answer No. 04

- a.
- i. Cost vs. benefits
 - ii. Non routine transactions not being covered
 - iii. Human errors
 - iv. Management override
 - v. Collusion
- (4 marks)
- b.
- i. Relevant industry, regulatory, and other external factors including the applicable financial reporting framework
 - ii. The nature of the entity, including:
 1. its operations;
 2. its ownership and governance structures;
 3. the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and
 4. the way that the entity is structured and how it is financed to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements.
 5. The entity's selection and application of accounting policies, including the reasons for changes thereto.
 6. The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.
 7. The measurement and review of the entity's financial performance
- (3 marks)
- c.
- (i)
 1. No segregation of duties with respect to payroll functions which can result in paying salaries for non-existing employees
 2. No authority levels in recruiting staff which can result in recruiting unnecessary staff or bias selections
 3. Factory manager may not have adequate time to handle production related issues due to time spent on payroll functions
 4. Amount paid through petty cash may not get recorded as salaries in the ledgers
 5. Procedure on recording of attention of staff is not satisfactory.
Or any other relevant weakness
- (4 marks)

- (ii)
1. Segregation of duties by obtaining the services of an attendance clerk to keep records
 2. Implement an appropriate approval system with head office HR division in recruiting staff
 3. Set limits in obtaining casual staff
- Any other relevant answer

(4 marks)
(Total 15 marks)

Answer No. 05

- (a)
- i. Significance of the potential misstatement in the assertion and the likelihood of its having a material effect, individually or aggregated with other potential misstatements, on the financial statements.
 - ii. Effectiveness of management's responses and controls to address the risks.
 - iii. Experience gained during previous audits with respect to similar potential misstatements.
 - iv. Results of audit procedures performed, including whether such audit procedures identified specific instances of fraud or error.
 - v. Source and reliability of the available information.
 - vi. Persuasiveness of the audit evidence.
 - vii. Understanding of the entity and its environment, including the entity's internal control

(4 marks)

- (b)
- i. Materiality
 - ii. Assessed risk
 - iii. Degree of assurance expected

(3 marks)

- (c)
- (i) We were unable to obtain sufficient appropriate audit evidence in respect of investments in fixed deposits amounting to Rs. XXX stated in note x to the financial statements.

(4 marks)

- (ii) The company had not accounted for its investment in accordance with the requirements of the Sri Lanka Accounting Standards. Had management accounted for investments as required by the applicable standards, the net profit and the net assets of the company would have been reduced by Rs. 203 million.

(4 marks)
(Total 15 marks)

Answer No. 06

- (a)
- i. Consistent application of predefined business rules and perform complex calculations in processing large volumes of transactions or data
 - ii. Enhance the timeliness, availability and accuracy of information
 - iii. Facilitate additional analysis of information
 - iv. Enhance the ability to monitor the performance of the entity's activities and its policies and procedures
 - v. Reduce the risk that controls will be circumvented
 - vi. Enhance the ability to achieve effective segregation of duties by implementing security controls in application, databases and operating systems
- (2 marks)
- (b)
- i. The extent to which the computer is used in each significant accounting application
 - ii. Complexity of the entity's computer operations
 - iii. The organizational structure of the computer's processing activities
 - iv. The availability of data for evidential matter
- (3 marks)
- (c)
- i. Bank and legal confirmations obtained as part of the auditor's procedures;
 - ii. Minutes of meetings of shareholders and of those charged with governance;
 - iii. Third-party confirmations obtained by the auditor (in addition to bank and legal confirmations).
 - iv. Entity income tax returns.
 - v. Information supplied by the entity to regulatory authorities.
 - vi. Shareholder registers to identify the entity's principal shareholders.
 - vii. Statements of conflicts of interest from management and those charged with governance.
 - viii. Records of the entity's investments and those of its pension plans.
 - ix. Contracts and agreements with key management or those charged with governance.
 - x. Significant contracts and agreements not in the entity's ordinary course of business.
 - xi. Specific invoices and correspondence from the entity's professional advisors.
 - xii. Life insurance policies acquired by the entity.
 - xiii. Significant contracts re-negotiated by the entity during the period.
 - xiv. Internal auditors' reports.
 - xv. Documents associated with the entity's filings with a securities regulator (for example, prospectuses).
- (5 marks)
- (d)
- i. New conditions or events had occurred that gave rise to the need for change in accounting estimates specifically, the technological changes
 - ii. Management intentions in changing accounting estimate and whether there are any plans for investing in new machinery within the next two years
- (2 marks)
- (e)
- i. Integrity of principal owners, key management and those charged with governance of the entity
 - ii. Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources
 - iii. Whether the firm and the engagement team can comply with relevant ethical requirements
- (3 marks)
(Total 15 marks)

Answer No. 07

- (a)
- i. The nature of the entity
 - ii. The purpose of the summary financial statements
 - iii. The information needs of the intended users of the summary financial statements
 - iv. Whether the applied criteria will result in summary financial statements that are not misleading in the circumstances.

(3 marks)

- (b)
- i. Nature of the engagement including the fact that the procedures performed will not constitute an audit or a review and that accordingly no assurance will be expressed.
 - ii. Stated purpose for the engagement.
 - iii. Identification of the financial information to which the agreed-upon procedures will be applied.
 - iv. Nature, timing and extent of the specific procedures to be applied.
 - v. Anticipated form of the report of factual findings.
 - vi. Limitations on distribution of the report of factual findings. When such limitation would be in conflict with the legal requirements, if any, the auditor would not accept the engagement.

(5 marks)

- (c)
- i. As evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor
 - ii. As evidence that the audit was planned and performed in accordance with SLAuSs and applicable legal and regulatory requirements.
 - iii. Assisting the engagement team to plan and perform the audit.
 - iv. Enabling the engagement team to be accountable for its work.
 - v. Retaining a record of matters of continuing significance to future audits.
 - vi. Enabling the conduct of quality control review and inspection in accordance with SLSQC1.
 - vii. Enabling the conduct of external inspections in accordance with applicable, regulatory and other requirements.

(3 marks)

- (d) The auditor cannot rely only on the management representation.
Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Therefore, auditor may consider a qualified opinion due to limitation of scope as sufficient appropriate audit evidence is not available.

(2 marks)

- (e)
- i. Random selection of the sample items
 - ii. The use of probability theory to evaluate sample results, including measurement of sampling risk.
 - iii. Population should be homogeneous

(2 marks)

(Total 15 marks)



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