

KE 4 - PROCESSES, ASSURANCE & ETHICS
Suggested Answers and Marking Grid

SECTION 1

Question 01

1(a)

1.1.

Learning Outcome:
2.1.1 Identify activities connected with the procurement process, such as: <ul style="list-style-type: none">- Vendor selection and evaluation- Budgetary controls- Placing orders- Receiving- Payment

Correct answer: D

Payment voucher is the document that is used to authorize payments to suppliers and other parties. All other options are relevant to downstream activities of the procurement cycle.

1.2.

Learning Outcome:
1.5.3 Identify the role of the internal control system in an entity in mitigating risk at the business process level.

Correct answer: A

Internal control system of an entity consists of policies & procedures introduced by management. If internal controls are operated effectively, all policies and procedures are duly adhered by staff in performing their duties.

1.3.

Learning Outcome:
5.5.2 Explain the meaning and the difference between test of controls and substantive procedures.

Correct answer: C

Performing analytical procedure is used as substantive testing. All three options other than "C" provide evidence of operating effectiveness of internal controls.

1.4.

Learning Outcome:

1.8.1 Identify the governance structure of a business organisation.

Correct answer: C

The objective of corporate governance is, overall performance enhanced by good supervision & management. Business is to be conducted in a way that is both ethical & effective from the perspective of all stakeholders, not just shareholders.

1.5.

Learning Outcome:

2.2.3 Assess the business risks connected with sub activities relating to the payroll process.

Correct answer: C

When a staff members takes leave, one other staff member is assigned to cover up the duty of the first staff member. In such event, if the first staff member has committed a fraud, it might get highlighted to the second staff member. Therefore staff members might not take full leave entitlement due to reason of this nature.

1.6.

Learning Outcome:

2.1.3 Assess the business risk connected with sub activities relating to the procurement process.

Correct answer: A

In "open account trade" documents are shipped directly to the importer expecting the importer to settle the due as agreed. In all other options, documents are not directly shipped to the importer and often banks are involved in the settlement process. Therefore, in open account transactions default risk is borne by the seller.

1.7.

Learning Outcome:

4.2.2 Explain integrity, objectivity, professional competence and due care, confidentiality and independence.

Correct answer: B

Financial details are confidential information of an audit client. As such auditor cannot distribute these data without the consent of the client unless required by law. Therefore, confidentiality is the key element here.

1.8.

Learning Outcome:

1.7.1 Discuss the inherent limitations of an internal control system.

Correct answer: C

Other than "Human judgment in decision making" all other options can be improved. For example, an ineffective board may be replaced with more effective personnel.

1.9.

Learning Outcome:

2.1.3 Assess the business risk connected with sub activities relating to the procurement process.

Correct answer: A

Ordering & raising GRNs are independent of recording purchases. Therefore, all purchase ledger entries should be supported with documents generated in each of the previous functions.

1.10.

Learning Outcome:

4.2.1 State the importance of ethical behaviour for a professional accountant.

4.2.2 Explain integrity, objectivity, professional competence and due care, confidentiality and independence.

Correct answer: D

All options other than "D" are related to the human qualities expected from professional accountants, whereas CSR is an initiative to assess and take responsibility for the company's effects on the environment and impact on social welfare.

Marking Guide

Each question carries 2 marks.

Total 20 marks.

1(b)

1.11.

Learning Outcome
1.3.1 Identify the different types of risks that an entity is exposed to (including those arising from both the internal and external environment of an entity).

- i. Reducing risk through internal controls
- ii. Transferring risk through insurance
- iii. Reducing risk through internal controls

1.12.

Learning Outcome:
2.5.2 Assess the business risks connected with sub activities relating to the inventory management process.

- i. Pilferage
- ii. Unrecorded Issue Notes
- iii. Over recording quantities received
- iv. Under recording quantities issued
- v. Unrecorded purchase returns
- vi. Supplier frauds - indicating higher quantity in the delivery note than what is actually in the shipment.

1.13.

Learning Outcome:
2.3.1 Identify activities connected with the cash management process, such as maintenance of cash book, petty cash book, bank reconciliations, investments, etc.

- i. Cheques issued but not presented to the bank
- ii. Unrealised deposits
- iii. Bank errors

1.14.

Learning Outcome:

3.3.1 Explain the importance of IT general controls and application controls in achieving control objectives in a given business process.

- i. Input controls
- ii. Processing controls
- iii. Output controls
- iv. Integrity controls

1.15.

Learning Outcome:

2.2.3 Assess the business risks connected with sub activities relating to the payroll process.

- i. Over/under payment to employees
- ii. Non-existent (bogus) employees may be paid
- iii. Former employees may continue to be paid
- iv. Incorrect payroll calculations

1.16.

Learning Outcome:

2.4.2 Assess the business risks connected with sub activities relating to PPE management process.

- Unique asset code has not been assigned to some assets in the FAR.
Implication
Physical existence of assets cannot be verified.
- FAR does not reconcile with the general ledger.
Implication
Accuracy and completeness of assets recorded in general ledger is in question. This may be due to nonstandard journal entries recorded in the general ledger.
- Furniture and office equipment had been included in capital work in progress for more than 3 months.
Implication
Furniture and office equipment are assets which are readily usable from the date of purchase and need not be held in capital work in progress. This may result in depreciation not being charged for assets which were in use.

1.17.

Learning Outcome:

1.5.2 Identify elements of internal control.

- i. Transaction processing systems
- ii. Expert systems
- iii. Decision support systems
- iv. Management information systems

1.18.

Learning Outcome:

1.7.1 Discuss the inherent limitations of an internal control system.

- i. Audit committee
- ii. Remuneration committee
- iii. Nominations committee
- iv. Risk management committee

1.19.

Learning Outcome:

5.1.2 Explain the key areas of the assurance framework, including elements, objectives, scope, etc.

- i. Practitioner
- ii. Responsible party
- iii. Intended user

1.20.

Learning Outcome:

5.1.1 Explain the concept of assurance.

- i. The use of testing (sampling)
- ii. Inherent limitations of internal controls (E.g. management override)
- iii. Nature of audit evidence, i.e. most evidence is persuasive rather than conclusive

Marking Scheme

Each question carries 3 marks.

Total 30 marks.

SECTION 2

Question 02

1.

Learning Outcome:

2.1.2 Identify the documents relating to procurement cycle, point of origination, flow of documents and purpose.

- i. Cash / cheque receipt - When cash / cheque received by cashier either from an outside party or internal party
- ii. Petty cash voucher – When making payment using petty cash
- iii. Journal voucher – When recording entries in the general ledger without the use of other primary books
- iv. Sales invoice – When selling goods to a supplier
- v. Goods received note – When good are received at stores
- vi. Purchase order – When goods are requested from a supplier
- vii. Delivery note – When delivering goods to a separate location from the stores
- viii. Material requisition note – When raw material is required at the production floor
- ix. Withholding tax deduction certificate on interest income – When a bank deducts withholding tax on interest paid
- x. Credit note – When a customer returns good

Marking Scheme

1/2 mark x 10 = 5 marks

2.

Learning Outcome:

2.1.2 Identify the documents relating to procurement cycle, point of origination, flow of documents and purpose.

- i. Bill of Lading
This is the document showing the title of the goods, transferable by endorsement and is a receipt from shipping company regarding the number

of packages with a particular weight received to transport to a named port of destination.

ii. CUSDEC

This is the document used to clear the goods from the customs.

iii. INCOTERMS

An abbreviation of International Commercial Terms which defines the division of cost between buyers and sellers, the point at which the delivery occurs and the party responsible of export and import clearance.

iv. Shipping guarantee

This is a document through which Shipping line is requested to release the goods imported based on the "Delivery Order" without surrender of the Bill of Lading on the indemnity that the importer countersigned by the bank for a value which is more than the invoice value.

Marking Scheme

1 1/4 marks x 5 = 5 marks

Question 03

Learning Outcome:

5.4.1 Define "audit evidence".

5.5.1 Explain the concepts and meanings of:

- | |
|---|
| <ul style="list-style-type: none">- Sufficient and appropriate audit evidence;- The nature, timing and extent of audit procedures. |
|---|

i. Inquiry

Use in gathering audit evidence:

Inquiry means requesting information. This could be from individuals within the company, either orally or in written representations, or in formal written request to third parties. This is primarily used to gain an understanding about the business and the processes and controls involved. Inquiries from third parties could be done to confirm the existence of assets/liabilities and to verify ownership of assets.

Example:

In the Toyland audit, sending a standard confirmation letter to the company's bank requesting details of bank account balances is a form of inquiry.

ii. Inspection

Use in gathering audit evidence:

Inspection means looking at documentation, books and records or assets. This could be done to confirm existence of an asset, to verify values or to provide evidence that a control has taken place.

Example:

Checking the serial continuity of bills recorded in the sales ledger to identify unrecorded bills can be considered as inspection.

iii. Observation

Use in gathering audit evidence:

Observation means watching a procedure being carried out. It is usually used as a means of gathering evidence about the internal controls of a company.

Example:

Auditors observing wages pay-out to determine the adequacy of internal controls over wages paid in cash.

iv. Recalculation

Use in gathering audit evidence:

Recalculation means the re-performance of an arithmetical process within the accounting system. This could involve re-checking manual calculations to confirm the accuracy and completeness of the figures.

Example:

Depreciation is a material expense of Toyland. The auditor should recalculate this expense to confirm its accuracy.

v. Analytical procedures

Use in gathering audit evidence:

Analytical procedures mean the study of trends and ratios in financial and non-financial information. It is used within audit planning to identify risk areas and also as a means of gathering substantive evidence.

Example:

A comparison of gross profit ratios month by month could be performed and any unusual fluctuations investigated as these could indicate errors such as omission of sales, loss of inventory or other errors.

Marking Scheme

Part 1: Use in gathering audit evidence:
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1 mark for well explained answer- maximum 5 marks

Part 2:Example:

1 mark for well explained example- maximum 5 marks
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Question 04

1.

Learning Outcome:

4.2.1 State the importance of ethical behaviour for a professional accountant.
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4.2.2 Explain integrity, objectivity, professional competence and due care, confidentiality and independence.

Saman has a conflict of interest in this instance as his brother is influencing him to act against the rules of the entity. Therefore, Saman needs to inform his superior of the situation and withdraw from handling the quotations.

He may advise the brother of his decision and inform him to submit the quotation as a late submission if required.

Marking Scheme

5 marks

2.

Learning Outcome:

4.2.2 Explain integrity, objectivity, professional competence and due care, confidentiality and independence.

- i. Integrity
Being straightforward and honest in all business relationships.
- ii. Confidentiality
Non disclosure of information relating to the employer or his client / customer for personal gain of the employee or of any 3rd party.
- iii. Independence
A professional accountant is required to be independent in mind and in appearance to accept an assurance engagement in order to provide a reasonable assurance acceptable by all users.

Marking Scheme

Integrity - 1 mark

Confidentiality - 2 marks

Independence - 2 marks

Question 05

1.

Learning Outcome:

3.2.1 Explain the importance of operating effectiveness of internal control.

1.6.1 Explain main control activities such as:

- Segregation of duties
- Physical controls
- Authorisation
- Business performance review
- Information processing controls

Lack of segregation of duties

1. Unauthorised changes to master data

Sunimal has full access to attendance system, payroll master data and payroll calculation programs in the system. If the Sunimal is responsible for payroll processing, providing access to master data is incompatible with his role. This

leaves room for unauthorised amendments to master data such as unauthorised changes to basic salary, activating resigned employees etc.

The HR manager has also given unrestricted access to all 3 modules of the payroll system and this access rights may be misused.

2. Unauthorised changes to attendance

It shows that Sunimal has the access to change attendance details of the system. Although invalid SWIPs are to be cleared there should be adequate controls over changes to attendance data.

3. Unauthorised changes to bank file

It appears that Sunimal is responsible for generating and forwarding bank payment file to bank. There is a risk that the salary details such as net pay and bank account details may be edited by Sunimal unless the bank payment file is protected.

4. Attendance system is not aligned to the payroll system

System has calculated salary for resigned employees, this indicates that the salary can be processed without attendance being recorded in the system and is a fundamental flaw in the process. This may be due to attendance system not being integrated to payroll system.

5. Weak controls over cash salary payments

Unclaimed salaries had been subsequently misappropriated by forging the signature of the correct employees. This indicates that there is no adequate verification of the identity of the employee before making the salary payment.

6. Lack of data validation controls

There had been employees who were paid for more than 24 hours OT per day. This means that the system will not restrict unusual attendance being captured.

7. Payroll reconciliation process

It is doubtful that Anupama Garments has an effective payroll reconciliation process where the basic salary of the previous month is reconciled with current month in terms of changes in basic salary and number of employees. If such reconciliation was in place, salary process to resigned employees would have been revealed.

Marking Scheme

1 mark will be allocated for each of the five internal control deficiencies properly identified.

Maximum of 5 marks to be allocated.

2.

Learning Outcome:
3.1.1 Recognise the importance of design effectiveness of control in achieving the objectives of a given business process.
1.6.1 Explain main control activities such as: <ul style="list-style-type: none">-Segregation of duties-Physical controls-Authorisation-Business performance review-Information processing controls

1. Unauthorised changes to master data

- Restrict access rights to authorised personnel. The person who is processing the payroll should not be given the access to master data.
- Review of system generated audit trail is an important detective control.

2. Unauthorised changes to attendance

Sunimal should not be able to change the attendance data without the approval of a superior and the written acknowledgment of the employees should be obtained for changes to attendance data.

3. Unauthorised changes to bank file

- Introduce data encryption to protect the bank payment file from unauthorised changes
- Assign generation and submission of bank file to finance

4. Attendance system is not aligned to the payroll system

System modification to ensure that salary cannot be processed without attendance being recorded.

5. Weak controls over cash salary payments

- Check the identity of the employee before making the cash payment
- Payments with the presence of the division heads

6. Lack of data validation controls

There should be data validation controls to ensure that the actual OT hours worked will not exceed a predefined limit e.g. 6 hours of OT

7. Payroll reconciliation process

Review of system generated monthly payroll reconciliation by a superior based on the supporting documents

Marking Scheme

1 mark will be allocated for listing five risk mitigating strategies.
Maximum of 5 marks to be allocated.

SECTION 3

Question 06

1.

Learning Outcome:

1.5.3 Identify the role of the internal control system in an entity in mitigating risk at the business process level.

- To ensure that all cash to which the entity is entitled is received.
- To ensure that all such cash is properly accounted for and recorded in the entity's records.
- To ensure that cash is adequately safeguarded.
- To ensure that all such cash is banked promptly and intact.

Marking Scheme

1 mark for each correct answer
Maximum 3 marks

2 and 3

Learning Outcome:

Part 2

3.1.1 Recognise the importance of design effectiveness of control in achieving the objectives of a given business process.

3.2.1 Explain the importance of operating effectiveness of internal control.

Part 3

1.6.1 Explain main control activities such as:

- Segregation of duties
- Physical controls
- Authorisation
- Business performance review
- Information processing controls

3.1.1 Recognise the importance of design effectiveness of control in achieving the objectives of a given business process.

<u>Control deficiency</u>	<u>Consequences</u>	<u>Suggested control</u>
Cashier collects cash, updates cash book & sales ledger. This is weak segregation of duties.	Increased risk of fraud & error misuse of cash.	Cashier should update the cash book. Another clerk should update the sales ledger.
Receptionist opens the post unsupervised.	This could result in cheques being misappropriated.	An independent officer should supervise the opening of mails and sign-off the cheque register entries.
Cash and cheques are banked every few days.	Misappropriation of collection by staff.	Cash and cheques should be banked every day.
Any member of the finance team collects cash when cashier is absent.	Lack of accountability for collection could result in misappropriation.	One member of the finance team should be appointed to collect cash if the cashier is absent.
Cashier's password is shared with other clerks.	Difficulty in assigning responsibility for frauds & errors since computer systems identify the user based on login details.	Separate login account should be given to the nominated person to access the system.
Bank reconciliations are not reviewed by the Accountant consistently.	Errors in the cash cycle may not be promptly identified.	A responsible officer (accountant) should check & approve all bank reconciliations.

Marking Scheme

1 mark for identification of deficiency (maximum 5 marks), 1 mark for identifying consequences (maximum 5 marks), 1 mark for correct control recommendation (maximum 5 marks)

4.

Learning Outcome:

1.7.1 Discuss the inherent limitations of an internal control system.

- Employees by-passing controls through collusion.
- Management override.
- Human error, judgment & misunderstanding could result in control failure.
- Internal control systems are not capable of dealing with non-routine transactions.
- Cost of implementing internal control systems may exceed benefits.

Marking Scheme

1 mark for each correct answer - maximum 2 marks
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