

CA



THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

KE4 – Processes, Assurance & Ethics

March 2015

SECTION 1

Answer 01

1 (a)

- | | |
|-------|--|
| 1.1 | Relevant Learning Outcome: 1.1.1
Correct answer: C |
| 1.2. | Relevant Learning Outcome: 1.2.4
Correct answer: D |
| 1.3 | Relevant Learning Outcome: 1.9.1
Correct answer: D |
| 1.4 | Relevant Learning Outcome: 2.1.2
Correct answer: D |
| 1.5 | Relevant Learning Outcome: 2.5.1
Correct answer: A |
| 1.6 | Relevant Learning Outcome: 3.2.1
Correct answer: C |
| 1.7. | Relevant Learning Outcome: 4.1.1
Correct answer: D |
| 1.8 | Relevant Learning Outcome: 5.1.1
Correct answer: A |
| 1.9 | Relevant Learning Outcome: 5.2.1
Correct answer: C |
| 1.10. | Relevant Learning Outcome: 5.5.1
Correct answer: A |

[Total marks for 1(a) (MCQs) 2x10= 20 marks]

1 (b)

1.11

Relevant Learning Outcome: 1.4.1	
(i)	Risk assessment. Risk identification Analysis and evaluation.
(ii)	Risk response / risk treatment – Decides most appropriate methods of managing the risk.
(iii)	Monitoring and review

1.12.

Relevant Learning Outcome: 1.7.1	
1.	If the “tone at the top” (board of directors and senior management) of the organization on internal control effectiveness and the awareness on risk culture is weak, the effectiveness of internal control system will be affected.
2.	Internal controls may help reduce operational risks, however, they may not be able to prevent operational failures.
3.	Design of controls may be defective and consequently, it may not provide intended operational benefit/s.
4.	Controls introduced may not have been implemented.
5.	Due to rapid changes in the environment, new risks may emerge. However, the existing system of internal control may not be geared to tackle such situations.
6.	Cost of design and implementing control system may be far beyond the additional benefits.
7.	Human error
8.	Collusion between employee and fraudsters.
9.	Overriding of controls by management

1.13

Relevant Learning Outcome: 2.3.1	
1.	Decide on the imprest amount.
2.	Appoint a petty cashier.
3.	Makes a formal requisition for cash to be withdrawn from bank account.
4.	The accountant responsible for the bank account arranges for withdrawal of money.
5.	On receipt of money from the bank, put them in a petty cash box or safe.
6.	Recording withdrawal of money in the cash book.
7.	Establishing account in the accounting system to record petty cash receipts and expenses.
8.	Recording receipt and expenditure of petty cash in the petty cash book supported by a petty cash voucher and supporting document.

1.14.

Relevant Learning Outcome: 2.3.2
<ol style="list-style-type: none">1. Cash removed/paid out without being supported by an authorized petty cash voucher.2. A payment in excess of the stated value of an authorized petty cash voucher.3. A missing petty cash voucher.4. Potential theft.5. A missing IOU.6. Surplus related differences.

1.15

Relevant Learning Outcome: 3.1.1
<ol style="list-style-type: none">(i) Risks are not properly assessed. As a consequence the need for controls not recognized.(ii) Risks are recognized for routine operations but not for non-routine situations. As a result there will not be controls to deal in non-routine circumstances.(iii) Controls are not automated, but require response from an individual. Automated controls are more effective than controls requiring a human response.(iv) The control measure is not sufficient to achieve its purpose / objective.

1.16

Relevant Learning Outcome: 3.3.1
<ul style="list-style-type: none">- When access is restricted for the approved price list of the company, only authorized persons can access to the approved prices.- This will prevent unauthorized amendments or changes to the approved prices,- This will ensure the sales are done at the correct price and no one can choose a wrong price in generating sales invoices.- This will prevent unauthorized access to confidential information.

1.17

Relevant Learning Outcome: 3.4.1
<p>The following are examples of deficiencies that may be presented by candidates.</p> <ul style="list-style-type: none">• Purchase of materials/services without following procurement procedures. E.g. without an approval for purchase requisition/purchase order.• Receipt of materials/services without a proper checking over the specifications, quality and quantity/output• Supplier account has been credited without evidence to support receipt of materials/services• Inadequate segregation of duties among the ordering and approval of payment for purchases <p>The above list is not exhaustive</p>

1.18

Relevant Learning Outcome: 4.2.2	
1.	Where disclosure is permitted by law and is authorized by the client or employer.
2.	Where disclosure is required by law; for example to provide documents or other evidence in legal proceedings.
3.	Where disclosure is required by law of actual or suspected money laundering or terrorist financing
4.	Where there is a professional right or duty to disclose information, which is in the public interest and is not prohibited by law <ul style="list-style-type: none">* to comply with the quality review of a professional body* to respond to an inquiry or investigation by a regularity body* to protect the professional interest of a professional accountant in legal proceedings.* to comply with technical standards and ethics requirement.

1.19

Relevant Learning Outcome: 5.1.2	
1.	Intended users. These are the person, persons or class of persons for whom the practitioner prepares the assurance report.
2.	The responsible party is the person or persons responsible for the subject matter or subject matter information. This is the party that engages the practitioner to carry out the assurance engagement.
3.	The practitioner is the individual providing professional service that will review the subject matter and provide assurance

1.20

Relevant Learning Outcome: 5.3.1	
-	Deciding the nature, timing and extent of audit procedures. This means reaching a view about what work should be done in the audit
-	Judging whether sufficient appropriate audit evidence has been obtained
-	Evaluating management's judgment in applying the applicable financial reporting framework.
-	Drawing conclusions based on the audit evidence obtained; reaching an audit opinion (how to consider significant matters noted in forming an opinion)

[Total marks for 1(b) 3 x10= 30 marks]

SECTION 2

Answer 02

Relevant Learning Outcome/s: 1.6.1

- 1 Internal controls are important:
- All the business organisations have risks (e.g. risk of fraud, risk of omissions etc., operational risks). When controls are implemented it reduces risks at the level of business processes and operations.
 - Controls ensure compliance with laws, regulations applicable to the entity
 - Controls reduce the risk of loss of efficiency or effectiveness in business operations, ensure operations are conducted in accordance with organization policies and objectives.
 - Controls ensure reliability and accuracy of financial information processed through the entity's system
 - Ensure assets are safeguarded including information.
 - Fraud is prevented or detected if it occurs.
- (3 marks)
- 2
- It reduces the risk of fraud and will be able to detect the errors or omissions made by person who initiating the transactions if those are checked by another person in the organization.
 - It makes difficult for an individual to commit fraud.
- (3 marks)
- 3
- High value small items that are moveable easily can be kept in lockable cabins / cupboards
 - The management can have CCTV cameras and monitor stores (but this may be expensive)
 - Assign a responsible person to monitor the movements of those items and make him responsible for any shortage of items.
 - Implement necessary requirements to obtain insurance cover.
 - Frequent stock verification.
- (2 marks)
- 4 The objective of controls on arithmetical and accounting records is to check the correct and accurate recording and processing of transactions. For example reconciling sales ledger with the general ledger is an arithmetical and accounting control and it will ensure accuracy and completeness of sales recorded in the ledger.
- (2 marks)
- (Total: 10 marks)**

Answer 03

Relevant Learning Outcome/s: 5.5.2; 5.5.3

1. **Explain** how the following can be used in obtaining audit evidence in relation to inventory balance at the outlet.

i. Inspection

Existence of certain selected items recorded as inventory at the outlet can be assessed through inspection. Examination of all inventory items recorded gives evidence of completeness. Scrutinizing underlying invoices and records will also provide evidence on accuracy of valuation, rights and obligations and transactions are recorded in the correct accounting period (cut-off).

ii. Observation

Watching the general state of inventory and conditions under which it is stored or observing how a process or activity is performed in relation to inventory. This gives evidence of conditions prevailed at the time of gathering audit evidence in relation to inventory. Evaluating a stock count.

iii. Recalculation

All information pertaining to inventory receipts, issues and transfers could be extracted to recalculate the book balance of inventory at the period end which will provide comfort on accuracy of inventory balance. Method used in valuation of inventory could also be checked through recalculation to ensure accuracy.

(6 marks)

2. **Explain** the meaning of tests of controls.

Tests of controls are assessments designed to evaluate effectiveness of internal controls deployed by the organization in preventing or detecting and correcting material misstatements at the financial statement assertion level.

(4 marks)

(Total: 10 marks)

Answer 04

Relevant Learning Outcome/s: 2.2.2; 2.2.3

- 1 The importance of recording attendance of employees:
- The payments such as salaries overtime, attendance incentives and deductions such as no pay leave are determined based on the attendance of employees. Therefore the attendance record is important. It ensures that payments are made only to those who have worked in the company. (2 marks)
- 2 When using the swipe card to record the attendance, any other person can swipe the card on behalf of the owner of the swipe card. This is a manipulation and as a result the time will be recorded inaccurately. (2 marks)
- 3 The activities of HR division to ensure complete and accurate payroll:
- (i) The details of new recruits should be accurately maintained and submit timely for the payroll preparation
 - (ii) If HR division has time records those should be verified and provide for the payroll preparation
 - (iii) The details of resigned employees should be updated and pass those information to payroll preparation and ensure resigned employees are not paid.
 - (iv) Any changes to the salaries (e.g. increments) need to be accurately maintained / updated in HR records and communicate those for payroll preparation.
This means the HR division has to update the records and need to ensure the records are up to date and also ensure that no one will have access to those records to make unauthorized amendments. (4 marks)
- 4 Purposes of monthly payroll reconciliations:
- a. Employees have been properly paid, unauthorized persons are eliminated.
 - b. Payroll expenses are applied to the appropriate accounts
 - c. Tax is paid to the Inland Revenue and reported accurately.
 - d. All regulatory conditions such as EPF, PAYE, union fees loans are deducted and paid.
 - e. Departmental salaries are reconciled with budget. (2 marks)
- (Total: 10 marks)**

Answer 05

Relevant Learning Outcome/s: 4.2.1; 4.2.3

1 Why ethical behavior is important to Gihan?

- Gihan is in the profession of accountancy and he is supposed to adhere to the professional code of ethics.
- Since he is in financial reporting function, there are users of those reporting who will rely on those and make decisions. Especially Gihan is working for a public listed company and as a result there are wider coverage of users of financial statements. Therefore, it is Gihan's responsibility to prepare those financial statements accurately.
- The financial statements to be prepared honestly as the tax payments also depend on these. Therefore Gihan's ethical behaviour serves to protect public interest.
- Gihan is expected to be technically competent and make correct decisions as the employer will rely the work of Gihan as the accountant.

(3 marks)

2 Gihan's annual bonus is determined based on the profits earned by the company. He knows if the impairment charge is recognized there is a deterioration of profits which will affect the bonus payment. He needs to make the correct decision but it is blocked due to his interests. It is called "self-interest". Due to his financial benefit he can decide not to go ahead with impairment charge recognition.

(3 marks)

3 Protection available for Gihan:

Gihan has to be committed to the ethical behavior in this regard. He has to forget about his financial interest and discharge his duties.

2 marks)

- 4
- Integrity
 - Objectivity
 - Professional behaviour
 - Confidentiality

2 marks)

(Total: 10 marks)

SECTION 3

Answer 06

Relevant Learning Outcome: 2.4.1

1 Since these require significant amount of funds which are limited management can prepare a budget which is called capital expenditure budget. It is a planning framework and the budget can be monitored in order to ensure the limited funds are utilized effectively. This will also a formal procedure for authorizing items of capital expenditure.

(2 marks)

2 Process to follow in selecting a contractor:

- The company should identify a number of contractors who seem to have the resources and ability to deliver the service and these suppliers should be asked whether they would be interested in bidding for the contract in a tender process. (the process of calling for expression of interest and request for a proposal should be followed)
- The suppliers who indicate their willingness to tender for the contract are given specifications, setting out details of the contracting requirements for the construction. (this is generally done by way of providing high level architectural design, lay outs and high level specifications etc.).
- Each supplier is asked to submit a bid or tender, and a final date is given for submission.
- Within each tender the contractor should be asked to provide information that demonstrate their ability to deliver the service on time and to specification.
- The tenders or bids from the contractors are assessed by the Tender Evaluation Committee (TEC) and the preferred supplier is selected on the basis of the tender evaluation.
- A preferred bid may be recommended by either tender board or any relevant authority responsible for the tender process, but the final decision should be made at appropriate level of management (e.g. board of directors)
- If the contractor was not selected based on the lowest bidder, the decision should be justifiable and it should be recorded.

(6 marks)

3 **Benefits of a Fixed Asset Register (FAR)**

- (i) It is easy to identify the location of assets if it is included in a FAR
- (ii) It enables the company to physically check the fixed assets
- (iii) Enabling the accountants to calculate the profit or loss when the asset is eventually disposed of providing detailed records of the individual non-current asset
- (iv) Providing a record for checking the accuracy of the non-current asset records in the accounting system
- (v) To obtain non-financial information such as model and serial number.

(6 marks)

4 Data to be recorded in the FAR:

- Internal reference number for the asset
- The manufacturer's serial number
- Description of the asset
- Physical location of the asset
- Department that owns the asset
- Purchase date
- Cost
- Depreciation method, useful life
- Accumulated depreciation
- Model number and serial number
- Disposal proceeds

(4 marks)

5 Instances of removing assets from FAR

- Disposal of assets due to sale, scrapping the assets, donation, transfer of, goods requirements
- Stolen of an asset
- Destruction or loss of asset

(2 marks)

(Total: 20 marks)

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