

## KC4 – Corporate Governance, Assurance and Ethics

### February 2020

#### Examiner's Comments

##### General Comments

This examination consisted of two sections. Section 1 contained two compulsory questions carrying 25 marks each, and section 2 contained one question carrying 50 marks which was based on the common pre-seen.

Overall performance in this examination was disappointing. Students seem to have been under more time pressure than in other sittings. It was noted that candidates appeared to have spent more time answering question 3, and less time answering the other two questions. Candidates are reminded of the need to allocate their time appropriately. It is an obvious point to make, that attempting only two questions makes it more likely that candidates will fail. Candidates are also advised to read the question and plan their answer without being hasty, and writing the answer, without preparation.

It was noted that candidates had demonstrated a lack of subject knowledge and poor exam techniques. It is vital that, in this type of exam, students should spend some time reading the information provided, and consider how this information can be applied, when answering questions.

##### Specific comments

##### Section 1

##### Question 01

Requirement (a) carrying 4 marks required students to explain 4 procedures P&P should carry out, prior to accepting nomination, for the audit. This requirement was reasonably well met. There were some candidates however, who lacked subject knowledge, or misunderstood the statement in the scenario, which stated that "GPL or its management were not known to P&P". They took the view that as the client is not known it will be difficult to carry out the audit. Some answers had not been tailored to the question, but simply provided a list of procedures. Some candidates had misunderstood the requirement in the question, and had written the procedure that the auditor should carry out, after accepting nomination.

Part (b) carrying 6 marks, required candidates to evaluate the effect of matters described in the given issues. Many candidates had identified the issues, but failed to evaluate them. Candidates are advised to learn to evaluate issues. Most candidates had reproduced the facts given in the scenario, without identifying the threat which needed to be understood, before accepting the audit engagement. Some candidates had identified threats which were not relevant to the issues i.e. conflict of interest, familiarity etc., Some candidates had written advice to P&P, requesting them not to accept, or to accept the audit.

Part (c) This part carried 6 marks. Students were required to evaluate the sufficiency and appropriateness of the audit evidence obtained by the audit team. Some candidates were better able to identify that the evidence obtained was insufficient and had suggested that further audit procedures be carried out. Some candidates had simply listed audit procedures such as checking subsequent settlements, crosschecking invoices with general ledger, checking dispatch notes etc., without addressing the issue of sufficiency and appropriateness of the evidence obtained, as per the scenario described. Some candidates, not comprehending what was required in the question, suggested that the audit report be qualified. Candidates are advised to read the question carefully and plan their answers accordingly.

Part (d) This part carried 5 marks and candidates were required to evaluate the appropriateness of the paragraph suggested by the audit senior, to be included in the auditors' report. The indicators in the scenario gave rise to 'going concern' issues. In general, this part was well done. Many candidates identified that the paragraph suggested by the audit senior was an 'emphasis of matter' paragraph. Many were proficient at highlighting the sequence of matters, i.e. existence of material uncertainty, appropriate disclosure including mitigating measures not made in financial statements, and that only if Management agrees to make required disclosure, the emphasis of matter paragraph could be used.

Part (e) This part carried 4 marks. Candidates were required to advise the Senior in charge of the audit, how he should deal with the matter - where Silk Fabric had not recognised an impairment charge on its non-current assets as per LKAS 36. This part was well handled, with candidates explaining that the accounting treatment was factually incorrect. There were significant inconsistencies in some answers, where candidates stated that the issue was not material, yet they concluded that the Auditors' report be modified with an emphasis of matter paragraph. They demonstrated lack of technical knowledge, failing to understand that an emphasis of matter paragraph is not a substitute for a modified opinion.

## Question 02

Part (a) of the question also was scenario based, and carried 8 marks. Candidates were required to evaluate the internal environment of S&S. Internal environment is the framework within which the entity operates, which is determined by Management. Internal environment includes governance, management functions, their attitudes, and actions concerning internal controls and their importance in the entity.

The examiner expected candidates to comment on four aspects. Most candidates understood what was required in the question and answered well. Some candidates failed to comprehend what exactly was required, and they listed the four aspects as human resources, procurement, financial control & inventory. Some candidates just reproduced the facts given in the scenario without evaluating the internal environment of S&S.

Part (b) of the question which carried 6 marks required the candidates to recommend three risk mitigating measures S&S should take, to address the business risks arising, due to changes in the external environment. Some candidates failed to comprehend what was required in the question, which was to recommend mitigating measures for issues identified in the external environment. They wrote mitigating measures for issues identified in the internal environment. Candidates are advised to read the question properly and plan the answer.

Part (c) of the question carried 3 marks, and required the candidates to propose controls for the given issues. This part was well done. Some candidates however, had written lengthy answers, ignoring the allocated marks for the part.

Part (d) of the question carried 4 marks, and required candidates to assess the effectiveness of the present incumbent, in the role of internal auditor of S&S. A majority of the candidates managed to assess effectiveness properly. Some candidates who had failed to read & understand the scenario given, had written that the incumbent held two posts and then discussed how it would affect the company.

Part (e) of the question carried 4 marks. Candidates were required to recommend 4 actions to enhance the effectiveness of the Internal Auditor. This part was well handled.

### **Question 03**

Question 3 was a 50 marks question - case study style, which was based on the common pre-seen. The client was a plantation company.

Part (a) This part of the question which carried 6 marks, was based on engagement quality review of a firm. The candidates were required to propose 3 important areas which would be subject to an appropriate engagement quality review, where Malini's involvement as EQCR was required. Some candidates understood the question and wrote relevant answers. A majority of the candidates however, failed to understand the question and wrote about the suitability of Malini for the post of EQCR. Most candidates had not planned answers for each of the parts, and as a result, confused the answer, with the answer which should have been given for part d). Some candidates had not attempted the part (a) at all. Candidates were advised to read and understand the Sri Lanka standard on quality control, as this area is frequently tested.

Part (b) of the question carried 6 marks. Candidates were required to evaluate the areas of role and authority, its membership and meetings of the Audit committee. A majority of the candidates had written relevant answers. Many candidates copied D 3 of the code, ignoring the fact that the question required candidates to use the audit committee charter and evaluate the proposed areas. The examiner expected candidates to compare the proposed audit committee with the audit committee charter and identify shortcomings and any sensitive areas. However, a majority failed to evaluate the issue properly and were not successful in obtaining full marks.

Although this is an open book exam, candidates are advised not to just copy the facts given in the Code of best practice on corporate governance. They should relate the relevant code to the given scenario and address what was required in the question, which was to evaluate these areas.

Part (c) which carried 8 marks required candidates to evaluate the issues surrounding the non-professional services provided by Pediris & co., to UEL. A majority of the candidates had identified that there would be threats such as self-review independence, but failed to explain how the threats would arise and how they would affect the professional service. There were only a few candidates who identified that the nonprofessional services provided by Pediris & co., was work relating to management and involved management decisions such as designing IT controls, which was a violation of SLAuS 220.

Part (d) carried 5 marks and required candidates to comment on Malini's role as EQCR,. The examiner expected to test the knowledge about SLAuS 220 with regard to the appointment of Malini as EQCR. Some candidates had not attempted this part of the question at all. Most of the candidates wrote answers which were to be written for part a) of the question. Some candidates who understood the question, answered well, referring to the issues in the pre- seen. Some answers tended to be very brief, often in 'bullet format' i.e. not experienced, not independent, not competent etc., which was not sufficient to gain satisfactory marks.

Part e 1) carried 5 marks and required candidates to comment on two unfavourable elements in UEL to be focused on, when understanding the control environment. Candidates demonstrated poor knowledge about control environment. Control environment is the framework within which controls operate. It includes the governance and management functions and attitudes, actions of management concerning the internal controls and its importance in the entity. There were only a few candidates who obtained satisfactory marks. Many candidates without comprehending the question listed areas which are vulnerable for the audit, such as impairment of non-current assets, fair valuation, revenue recognition, inventory valuation etc.

Part (e11 carried 14 marks and required candidates to recommend 7 key areas relating to the financial statements that should be focused on when carrying out the audit of 2019. Candidates were expected to analyse the given financial statements included in the pre-seen. Weaker candidates without paying adequate attention to what was required in the question, wrote irrelevant answers such as control environment, management overrides, accounting system, procedure to get listing etc. Some candidates identified areas such as investment property, cost of sales, investment in subsidiaries which are not key areas. Some candidates just listed the significant areas without (recommending) suggesting a 'best course of action' when carrying out the audit. As a result, they failed to obtain satisfactory marks. A majority of the candidates had used analytical procedures and written about areas without considering the significance of such areas. The examiner expected the candidates to focus on the significance due to

- subjectivity in the measurement
- significant judgements and estimations

Most candidates failed to address the areas of subjectivity, simply listing the areas, and failing to explain why such areas were considered as significant.

Part (e 111) carried 6 marks and required that audit procedures for two key areas be proposed. On average, performance was not satisfactory. Although some candidates had understood the question, they failed to address the following;

- Assessment of appropriateness of the valuation model
- Evaluation of judgemental inputs
- Assess the appropriateness of the expert valuer

Most of the candidates identified valuation of biological assets as a significant area to carry out audit procedure, but demonstrated poor technical knowledge, in valuation of biological assets. Many candidates wrote that, in order to check the valuation of biological assets, one should obtain independent valuation, obtain letter of representation etc., which answers were not adequate.

There were only a few candidates who identified leased assets as a key area which requires complex determination of incremental borrowing rates. Some candidates had given audit procedures for all key areas without concentrating on significant risks. Candidates are advised to refresh their knowledge on SLFRS16, and LKAS 41, as they are expected to apply technical knowledge and write relevant audit procedures.

## **Conclusion**

Candidates are requested to apply the principles and rules from their previous studies to more complex scenarios and demonstrate their ability to handle different issues in the common pre seen. They should keep abreast of current developments in the economy, in order to understand issues easily.

Candidates are also expected to have broader technical knowledge and be able to link to the relevant audit issues in a practical situation. Candidates are advised to practise past exam papers and review the model answers, together with examiners reports. They should be trained to manage time, and write specific points, to the requirements in the questions.