THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

SUGGESTED SOLUTIONS

06204 - Audit and Assurance

Certificate in Accounting and Business II Examination
September 2012

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

Answer No. 01

(a)

1. Practitioner
2. Responsible party (management)
3. Intended users

(3 marks)

(b) An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of evidence.

(3 marks)

(c)

1. Tax planning and advisory services
2. Assistance / advisory services on system implementation
3. Assistance / advisory services on financial reporting related areas
4. Agreed upon procedure engagements
5. Compilation of financial or other information.

(2 marks)

(d) (i)

1. Belief that the responsibility for preparation of financial statements lies with the practitioner rather than the management
2. General acceptance that the practitioner's primary responsibility is to detect fraud when in fact the practitioner's duty is to conclude whether or not the financial statements are materially misstated.
3. The users' narrow perception over the concept of materiality and testing on sample basis where the belief is that the practitioner should check and verify each transaction.
4. Misunderstanding that the" true and fair view" means the information in the financial statements are "correct".

(2 marks)

(ii)

1. By expanding the conclusion by clearly indicating scope, objectives, audit methodology and responsibilities of practitioner and management with regard to the engagement
2. By issuing an engagement letter which include the objectives, responsibilities, scope, terms and conditions relating to the engagement
3. By establishing audit committees under the principles of corporate governance

(2 marks)

(e) (i)

- Petty cash payments to be made with a properly authorized petty cash voucher.
- Subdivision of work amongst those who handle petty cash.
- Category of payments to be made by petty cash to be separately identified from those to be made by cheques.
- An impress system to be in place.
- A petty cash control account to be in place.
- Petty cash should be physically verified from time, to time agreed with the petty cash balance by an independent party.
- Prohibition of cash input other than central reimbursement, I.O.Us and cashing of cheques.
- Provision of a petty cash book with columns for expenses heading analysis columns.

(3 marks)

(ii)
1. Call for confirmation of balances.
2. Check subsequent settlement of balances.
3. Obtain an age analysis of debtors balances and determine the reasonableness of the provision for bad and doubtful debts.
4. Compare the ratio of debtors to credit sales with the same for previous period and the budget. Inquire if there are wide fluctuations.
5. Reconcile the "debtors ledger" with "debtors' control" account .
6. Check accuracy of opening balance brought forward
7. Check debtor cut-off accuracy.
8. Obtain or prepare a list of balances and test the casts

(3 marks)

(iii)
1. Balances representing large values.
2. Balances long overdue.
3. Credit balances in the debtors ledger.
4. Balances written off as bad during the year.
5. Nil balances on the balance sheet date.
6. Balances under dispute.
7. Balances exceeded the credit period.

(3 marks)

Answer No. 02

(a) 1. The <u>integrity</u> of the principal owners, key managers and those charged with governance of the entity
2. Whether the engagement team is competent to perform the audit engagement and has the necessary <u>capabilities</u> including time and resources
3. Whether the firm and the engagement team can comply with relevant <u>ethical</u> requirements
4. <u>Significant matters</u> that have arisen during the current or previous audit engagements and their <u>implications for</u> continuing the relationship

(4 marks)

(b) 1. Withdraw from the audit engagement where possible under applicable laws or regulations
2. Determine whether there is any obligation either contractually or otherwise to report the circumstances to other parties such as those charged with governance, owners or regulators

(4 marks)

(c) 1. Relevant industry, regulatory and other external factors
2. Nature of the entity including its operations, ownership and governance structure, etc.
3. Selection and application of accounting policies by the entity.
4. Objectives and strategies of the entity and those related risks that may results in risks of material misstatements.

(4 marks)

(d) (i) Inherent risk, Control risk and Detection Risk

(3 marks)

(ii)
- Inexperienced finance staff
- Poor standard of the finance staff
- Inadequate controls/lack of manpower
- Poor accounting records

(4 marks)

(e) (i) Due to the following inherent limitations in an audit the auditor is unable to detect material misstatements.
- The use of selective testing.
- Inherent limitations of internal controls, such as possibility of management override or collusion.
- The fact that much of the evidence available to the auditor is persuasive rather than conclusive.
- Use of judgment in gathering and evaluating evidence and forming conclusions based on that evidence.
- Involvement of estimates which are uncertain.

(4 marks)

(ii) Management of the company.

(2 marks)
(Total 25 marks)

Answer No. 03

(a) (i) Since Mr. Kamal had been a member of the audit committee of the company to be audited he is not independent. Even if he does not handle the audit of the said company, still it will not be independent in appearance. According to Code of Ethics to have a former director / officer of the assurance client as a member of assurance team may create self-review threats and familiar threat. Threat seems to be significant and safeguard could be considered to reduce the threat to an acceptable level.

(3 marks)

(ii) Mr. Jonson will not be independent in mind as he will be checking his own work during the audit. According to Code of Ethics when any product or judgment of a previous assurance or non-assurance engagement, needs to be re-evaluated in reaching conclusions on assurance engagement self-review threat to independence occurs.

Threat created would be significant, no safeguard could reduce the threat. Only possible action is to refuse to accept appointment.

(3 marks)

(b)
1. Disclosure is permitted by law and is authorized by client.
2. Disclosure is required by law. (any related example)
3. To comply with the quality review of a member body or professional body
4. To respond to an inquiry or investigation by a member body or regulatory body
5. To protect the professional interest of a professional accountant in a legal proceeding
6. To comply with technical standards and ethics requirement.

(2 marks)

(c)
1. Dispose of the direct financial interest prior to the individual becoming a member of the assurance team.
2. Remove the member of the assurance team from the engagement.
3. Withdraw or refuse to accept the engagement if financial interest cannot be disposed of in the case of audit partner.

(2 marks)

Answer No. 04

(a)
1. Whether sufficient appropriate audit evidence had been obtained
2. Whether uncorrected misstatements are material individually or in aggregate
3. Whether financial statements are prepared in all material respects in accordance with the requirements of applicable financial reporting framework
4. Whether financial statements adequately refer to or describe the applicable financial reporting framework

(4 marks)

(b)
1. Identify the entity whose financial statements have been audited
2. State that the financial statements have been audited
3. Identify the title of each statement that comprises the financial statements
4. Refer to the summary of significant accounting policies and other explanatory information
5. Specify the date or period covered by each statement comprising the financial statements

(3 marks)

(c) i. There is a scope limitation on the work of the auditor. This may lead to a modification of the audit opinion.

(2 marks)

ii. Qualified opinion – auditor expresses an adverse opinion on a particular aspect of the accounts which is considered material but not pervasive.

Disclaimer – Auditor states he is unable to form an opinion on truth and fairness of the financial statements, if the impact is material and pervasive.

(2 marks)

(d) The auditor may modify the audit report by including an emphasis of matter paragraph to highlight a matter affecting the financial statements which is included in a note to the financial statements that more extensively discusses the matter.

(2 marks)

Examples:

- To highlight a material matter regarding a going concern problem.
- When there is a significant uncertainty (other than going concern problem), the resolution of which is dependent upon future events and which may affect financial statements – outcome of exceptional litigation or regulatory action.
- Early application of a new SLAS that has had or continue to have a pervasive effect on the financial statements in advance of its effective date.

(4 marks)

Note: Other matter paragraph may also be considered if explained properly.

Examples:
- Disclosure about predecessor auditor.
- Restriction on distribution or use of the Auditor's report

(Total 15 marks)

Answer No. 05

(a) (i) Design – the accounting and internal controls are suitably designed to prevent, detect and correct material misstatement
Operation – the systems exist and have operated effectively at relevant times during the period

(2 marks)

(ii) Tests of details of classes of transactions, account balances and disclosures and analytical procedures.

(2 marks)

(b)
1. Significance of the potential misstatement in the assertion and the likelihood of having a material effect, individually or aggregated with other potential misstatements on the financial statements.
2. Effectiveness of management's responses and controls to address the risks.
3. Experience gained during previous audits with respect to similar potential misstatements.
4. Results of audit procedures performed including whether such audit procedures identified specific instances of fraud and error.
5. Source and reliability of the available information
6. Persuasiveness of the audit evidence
7. Understanding of the entity and its environment including internal controls.
8. Nature of items under examination.

(2 marks)

(c) Consider the risk of existence of fraud and error which results in material misstatement in financial statements and use professional scepticism throughout the audit.

(2 marks)

(d)
1. Possibility of the misappropriation of cash by the person who handle cash
2. Possibility of goods being sold without being recorded as sales and staff keeping the cash
3. Possibility of goods being misappropriated for private use.

Any other relevant answer

(4 marks)

(e)
1. Make inquiries regarding management's assessment of the risk that the financial statements are materially misstated due to fraud.
2. Make inquiries regarding management's process for identifying and responding to the risks of fraud in the entity
3. Make inquiries of management and others within the entity to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity
4. Make inquiries of the internal audit function regarding their knowledge of any actual, suspected or alleged fraud affecting the entity
5. Evaluate whether unusual or unexpected relationships that have been identified in performing analytical procedures including those related to revenue accounts may indicate risk of material misstatement due to fraud
6. Consider whether other information obtained by the auditor indicates risk of material misstatement due to fraud

(3 marks)
(Total 15 marks)

Answer No. 06

(a) 1. Control environment
2. Risk assessment
3. Control activities
4. Information and communication
5. Monitoring

(3 marks)

(b) (i) 1. No approval or pre- approved limits for credit period / credit limit / discount given to wholesale customers by outlet managers
2. No segregation of duties in the outlet – marketing carried out, invoices raised, goods delivered and cash received by the same person
3. Cash received not banked intact.
4. No follow up action on debtors by MD unless notified by outlet manager.

Any other relevant answers

(3 marks)

(ii) 1. Having pre-approved credit limit, credit periods for each customer
2. Pre-determined discounts based on sales volume
3. Approval of Managing Director if pre-determined limits are exceeded
4. Having a separate person to handle documentation work at outlets
5. Cash received to be banked intact at end of each day

Any other relevant answers

(4 marks)

(c) 1. Reliance on systems or programs that are inaccurately processing data, processing inaccurate data or both
2. Unauthorized access to data that may result in destruction of data or improper changes to data
3. Possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties, thereby breaking down segregation of duties
4. Unauthorized changes to data in master files
5. Failure to make necessary changes to systems or programs
6. Inappropriate manual intervention
7. Potential loss of data or inability to access data as required
8. Lack of transaction trial and hard copies.
9. Concentration of resources such as hardware, software and files.

(3 marks)

(d) 1. The extent to which the computer is used in each significant accounting application
2. The complexity of the entity's computer operations
3. Organizational structure of the computer's processing activities
4. Availability of data as evidence

(2 marks)
(Total 15 marks)

Answer No. 07

(a)
1. Discuss the expert's results with the management and expert
2. Perform additional audit procedures
3. Consider engaging or asking management to engage another expert

(3 marks)

(b)
1. Organizational status / Objectivity
2. Scope of function / Any constraints or restrictions
3. Technical competence
4. Due professional care
5. Communication

(4 marks)

(c)
1. Distribution to shareholders
2. Redemption of any shares.
3. Assistance by the company in purchasing its own shares
4. Amalgamation proposal

(4 marks)

(d) Agreed upon procedure engagement.

Objective: Objective is for the auditor to agree to carry out procedures of an audit nature between the client, practitioner and any third parties and to report on factual findings.

Reporting: Practitioner will report the factual findings to those parties that have agreed to the procedures.

Assurance expressed: No assurance is expressed. Practitioner simply provide a report on factual findings.

Users: Users are the parties agreed to the engagement and practitioner will restrict the report to those parties agreed to the engagement.

(4 marks)
(Total 15 marks)

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