

CA



THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

KE4 – Processes, Assurance & Ethics

September 2016

SECTION 1

Answer 01

1.1

Learning Outcome: 1.1
Business organisations, main processes, and external environment
Correct answer: B

1.2

Learning Outcome: 1.2
Enterprise risk management
Correct answer: C

1.3

Learning Outcome: 2.1
Procurement cycle
Correct answer: D

1.4

Learning Outcome: 2.2
Payroll/human capital management
Correct answer: C

1.5

Learning Outcome: 2.4
Property, plant and equipment management
Correct answer: C

1.6

Learning Outcome: 1.2
Enterprise risk management
Correct answer: D

1.7

Learning Outcome: 4.2
Professional ethics
Correct answer: C

1.8

Learning Outcome: 5.5
Sufficient appropriate audit evidence
Correct answer: A

1.9

Learning Outcome: 5.5
Sufficient appropriate audit evidence
Correct answer: D

1.10

Learning Outcome: 5.5
Sufficient appropriate audit evidence
Correct answer: B

(Total: 20 marks)

Answer 02

2.1

Learning Outcome: 1.8
Governance and risk
<ul style="list-style-type: none">• Provide effective leadership to the company/corporate governance• Decide on objectives, strategies, vision and mission of the company.• Ensure that the company does not expose itself to excessive risks in pursuing its objectives, review risk reports and implement risk management systems.• Introduce an internal control system. Review the design and effectiveness of the system of internal control.

2.2

Learning Outcome: 1.6
Elements of internal controls
Information about operational risks and controls are communicated to the people who are responsible for applying the controls. This aspect of an internal control system is concerned with ensuring that individuals are: <ul style="list-style-type: none">• Aware of what is expected from them.• Provided with sufficient detail on time to enable them to perform their control tasks effectively.

2.3

Learning Outcome: 2.1
Procurement cycle
<ul style="list-style-type: none">• When a new item is required• When an existing supplier's cost is too high• When an existing supplier can no longer supply the goods or is unable to meet the requirements of the company.• When the value of the contract is high and the buyer is required to obtain a good price.

2.4

Learning Outcome: 2.5
Inventory management
Business risks in relation to inventory management <ul style="list-style-type: none">• The tiles could be easily damaged. Therefore there is a physical risk to the inventory. The company may hold excessive finished goods. Certain designs may not appeal to the market. Therefore, they face the risk of obsolescence.• Risk of issuing the inventory to those who should not receive it.• The inventory records of the company may not be accurate or up to date (risk of errors in inventory records)• Risk of running out of inventory. Risk of accepting goods into the stores that do not match the items ordered.

2.5

Learning Outcome: 5.3
General principles of an audit of financial statements
Professional judgment is required in the following areas of an audit: <ul style="list-style-type: none">• Deciding the nature, timing and extent of audit procedures. In other words, reaching a view about what work should be done in the audit. For instance whether to rely on controls, to what extent the work should be performed, is there a requirement to perform interim work etc.• Judging whether sufficient appropriate audit evidence has been obtained. If risks were identified in certain areas, the auditor needs to ensure that sufficient audit evidence was obtained to address the risks identified. This involves judgment.• Evaluating management's judgments in applying the applicable financial reporting framework. Certain accounting standards and their interpretation is complex and require a greater degree of judgment.• Drawing conclusions based on the audit evidence obtained → reaching an audit opinion. The auditor needs to make a judgment, based on the findings of the audit evidence, whether those issues have a material impact on the financial statements.

2.6

Learning Outcome: 1.5

Role of internal controls in mitigating risk

An internal control system refers to processes put into effect by the board of directors and management. They are designed to provide reasonable assurance regarding the achievement of objectives in the following areas:

- Effectiveness and efficiency of operations.
- Reliability of financial reporting.
- Compliance with laws and regulations.

2.7

Learning Outcome: 1.4

Techniques of mitigating risk

- (i) Presently, the business focus is on software. Therefore, the management would be able to diversify the product portfolio for instance by selling hardware and related services including consultation/training.
- (ii) The products are sold in Europe. Therefore, the management can diversify sales into other regions, including selling in the local market. This is termed geographical diversification.

2.8

Learning Outcome: 4.2

Professional ethics

- Ethical behaviour includes compliance with laws and regulations, and accountants are expected to act within the law.
- The profession requires members to conduct themselves and provide services to the public according to certain standards. By upholding these standards, the profession's reputation and standing are protected.
- An accountant's ethical behaviour serves to protect the public interest.
- Consequences of unethical behaviour include disciplinary action against the accountant by their employer or professional body.

2.9

Learning Outcome: 5.5
Sufficient appropriate audit evidence
<ul style="list-style-type: none">• Existence Land of that particular value exists as at the balance sheet date• Rights Entity holds/controls the rights to its land• Completeness All land that should have been recorded, are recorded• Valuation and allocation Land is included in the financial statements at appropriate amounts

2.10

Learning Outcome: 5.4
Audit evidence
<p>The sufficiency of audit evidence is the measure of the quantity of audit evidence. The quantity of audit evidence required is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence.</p> <p>The appropriateness of audit evidence is the measure of the quality of it, that is, its relevance and reliability in providing support for the conclusions on which the auditor's opinion is based.</p>

(Total: 30 marks)

SECTION 2

Answer 03

Relevant Learning Outcome/s: 3.3
IT general controls and application controls

(a) **Importance of IT general controls and application controls for an entity**

Internal controls in IT systems are essential to provide reasonable assurance that IT systems will function as intended and fulfill their purpose effectively.

General IT controls help to create risk awareness in all IT applications. They are also necessary to ensure that IT applications are implemented with limited risks (i.e. there will not be any discontinuation of operations, no unauthorised access etc.)

Application controls are required to check for errors, and report (or automatically correct) errors that are detected. Since the management wants to ensure data input, processing and output is accurate and complete, it is essential to have IT application controls.

(b) **IT general controls to ensure continuity of operations**

- Store extra copies of programs and data files off-site
- Protect equipment against fire and other hazards
- Back-up power sources
- Establish disaster recovery procedures. E.g. availability of back-up computer facilities
- Have maintenance agreements and insurance

(c) **IT application controls**

- Sales prices are picked from the standard price database and this price cannot be amended/changed.
- If the quantity invoiced does not match the sale order quantity, the system provides an error message.
- The system does not allow an invoice to be raised if the required quantity of goods is not available.

(Total: 10 marks)

Answer 04

Relevant Learning Outcome/s: 4.2

Professional ethics

(a) (i) **Threats to professional ethical behavior**

- Self-interest threat
- Self-review threat
- Advocacy threat
- Familiarity threat
- Intimidation threat

(ii) **Threats to professional competence and due care**

- Time pressure – when there may not be enough time to complete a task properly
- Insufficient or inaccurate information
- Lack of resources (e.g. equipment or help)
- Lack of experience, knowledge or training

(b) **Ethical issue faced by Supun**

Supun is a chartered accountant and he is expected to behave professionally. He has a threat to independence and objectivity if he accepts the gift offered by the sales manager. The sales manager has asked him to record the stated sales in August 2016.

Offering of the gift is an attempt to influence the objectivity of the Supun's decisions, or make him do something that is not correct.

Gifts can give rise to self-interest and intimidation threats to an accountant's objectivity and confidentiality. Supun is now facing this issue. This gift seems significant and encourages unethical behaviour from Supun. There is a significant threat to compliance with the fundamental principles. As a chartered accountant, Supun has to be straightforward and honest in all his professional and business relationships.

(Total: 10 marks)

Answer 05

Relevant Learning Outcome/s: 2.5

Inventory management

- (a) (i) – copy of the purchase order (PO) is not sent to the warehouse to compare with the goods received
- copy of the GRN is not sent to the finance department to ensure that the goods have arrived at the warehouse, before making the payment.
- (ii) – the company may receive goods of a different quantity and quality from the PO, or may not receive the goods at all
- the finance department may pay for the goods which are less in quality and quantity or may pay for goods not received
- (b) (i) – to check whether the balance in the cash book and the balance in the bank's records are the same
- to identify errors or omissions in the cash book
- to identify mistakes that possibly could have been made by the bank
- (ii) – compare the bank statement with the cash book in order to identify differences.
- record necessary entries in the cash book such as bank charges.
- check the prepared bank reconciliation by the relevant authority.

(Total: 10 marks)

Answer 06

Relevant Learning Outcome/s: 5.1 and 5.3

5.1 Elements and objectives of an assurance engagement
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5.3 General principles of an audit of financial statements
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(a) (i) The objective of an assurance engagement is for the practitioner to provide either reasonable assurance or limited assurance on the subject matter.

(ii) S&S has been engaged to prepare financial statements based on the information provided by the management of the entity. The auditor does not need to gather any evidence on the accuracy and reliability of the information provided by the management. Therefore, this is not an audit or a review where the auditor will provide a level of assurance.

This engagement sounds like a compilation engagement, as the auditor has to compile the information and prepare a set of financial statements. Compilation is not an assurance engagement, as it does not have all the characteristics that an assurance engagement should have. This engagement needs to be considered as a non-assurance engagement (related service). The report should be a 'compilation' report.

(b) The audit needs to be conducted in accordance with Sri Lanka Auditing Standards. When audits are in compliance with auditing standards, they serve the following purposes:

- Auditors conduct their audit work to a standard that is considered appropriate and necessary for the purpose of the audit and reaching an audit opinion.
- Users of audited financial statements have the knowledge that the auditor's audit opinion is based on audit work that has been conducted in accordance with the standards of the audit profession.
- Auditing standards maintain the high standards of the audit profession and reinforce public confidence in the external audit of compliance with SLAuS is compulsory when carrying out the audits of entities specified by the Sri Lanka Accounting Standard Act No. 15 of 1995.

(Total: 10 marks)

SECTION 3

Answer 07

Relevant Learning Outcome/s: 2.1, 2.2.1 and 2.2.3	
2.1	Procurement cycle
2.2.1	Identify activities connected with the payroll process, such as recruitment, preparation and payment of salaries
2.2.3	Assess the business risks connected with sub activities relating to the payroll process.

(a) (i) Risks in the present payroll system

- Copy of the document (staff appointment form/appointment letter) confirming the appointment is not received by the payroll officer to create a new employee in the system.
 - HR assistant may claim fraudulent salaries by sending details of a non-existing employee → risk of payments to non-existing employees
 - HR assistant may send incorrect information to the payroll officer since information is not checked and authorised by an appropriate person → risk of receiving incorrect information by the payroll officer
- New employee creations are not authorised by an appropriate person and the payroll officer creates new employees at the request of the HR assistant
 - Risk of creating bogus employees → risk of payments to non-existing employees
 - Risk of removing existing employees → risk of employees not being paid salaries on time
- Attendance records are not maintained properly and the number of days worked are informed by the line manager
 - Not having accurate days and hours worked to calculate the salaries → risk of over/under payment of salaries.
 - 'Number of days worked' report submitted by the line manager can be incorrect → risk of over/under payments of salaries.
- Statutory deductions, no pay deductions etc. are not checked for accuracy.
 - Making inaccurate deductions → risk of over/under payment of salaries.
 - Making inaccurate deductions → risk of regulatory non-compliance.

- Approved leave records are not sent to the HR department by the relevant line manager.
 - The company may pay salaries even for leave taken → risk of overpayment of salaries

(ii) Controls to be established

- Letter of appointment has to be sent to the payroll officer.
- Attendance records system has to be implemented and approved attendance records have to be sent to the payroll officer.
- Access to the payroll master file shall be assigned to an appropriate authority to establish segregation of duties.
- Detailed checking shall be done on salary computations.
- Approved leave records have to be sent to the payroll officer.

(iii) Possible issues in the use of a swipe card system

- Another employee may swipe the cards on behalf of the relevant employee/owner of the card.
- System failures/technical issues/hardware failure.
- Employee may forget to swipe the card.
- If the system is integrated to the payroll system/ERP system, technical problems may arise.

(b) (i) Control weaknesses

- CAPEX budget and approvals are not verified before starting the tender process.
- Suppliers are not asked to demonstrate track records of similar contracts in the past. Evidence of their financial stability is not requested
- Head of procurement alone does the initial assessment.
- Only the price is considered in selecting the supplier and other factors such as quality are not considered.
- This has not been referred to a technical and financial evaluation committee.
- Called for expression of interest only from registered suppliers.

(ii) Risks in relation to the control weaknesses above

- Risk of acquiring assets without proper authorisation or in excess of the organisation's ability
- Risk that suppliers who bid are not capable of supplying the required goods.
- Risk of fraud – he may select suppliers to be submitted to the tender committee based on his preference and as a result inappropriate suppliers may get selected.
- Risk of receiving low quality assets.

(iii) **Disposal process in relation to property, plant and equipment**

- Obtain approval for disposal from an appropriate/established authority level.
- Appoint a tender committee to undertake disposals and call tenders/quotations from prospective buyers.
- Tender committee to evaluate the bids and give their recommendation to head of the organisation.
- Head of the organisation to obtain approval from the board of directors where necessary.

(Total: 20 marks)

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