

CA



THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

KE4 – Processes, Assurance & Ethics

September 2015

SECTION 1

1.1.

Learning Outcome: 1.1.2

Identify the key business processes in a business organization.

Correct answer: C

1.2.

Learning Outcome: 1.2.2.

Define "enterprise risk management."

Correct answer: C

1.3.

Learning Outcome: 2.1.1.

Identify activities connected with the procurement process,
such as :

Vendor selection and evaluation

Budgetary controls

Placing orders

Receiving

Payment

Correct answer: D

1.4.

Learning Outcome: 2.2.3.

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

Correct answer: B

1.5.

Learning Outcome: 2.2.1.

Identify activities connected with the payroll process, such as
recruitment, preparation and payment of salaries.

Correct answer: A

1.6.

Learning Outcome: 3.1.1.

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

Correct answer: A

1.7.

Learning Outcome: 3.4.1. Explain deficiencies in internal controls in a given business process
Correct answer: B

1.8.

Learning Outcome: 5.1.2. Explain the key areas of the assurance framework, including elements, objectives, scope etc.
Correct answer: C

1.9.

Learning Outcome: 5.2.1. Explain situations where assurance services can be rendered by a practitioner.
Correct answer: D

1.10.

Learning Outcome: 5.4.1. Define "audit evidence".
Correct answer: A

(Total: 20 marks)

Answer 02

2.1.

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).

- Increase in inflation rate – increase in cost of the company (salaries, other expenses)
- Decrease in GDP growth rate – low demand for the goods of the company
- Exchange rate fluctuations – increase in import expenses, low price for exports.
- Fluctuation in interest rates – increase in finance expenses
- Taxation policy - increase in cost, reduction in profit.

2.2.

Learning Outcome: 1.6.3

Identify the internal control monitoring mechanisms designed to ensure effectiveness of processes and business.

Senior management can monitor the effectiveness of the internal control system in the following ways:

- By direct observation and experience
- Reports from other risk management committees in the company
- Through the findings of external auditors
- If the entity has an internal audit function, the management may use the findings of internal auditors

2.3.

Learning Outcome: 2.3.3

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

Risks

- i. Receipts may be recorded incorrectly.
- ii. The outlet may not bank all cash collected during the day.
- iii. Cash collection gets stolen.
- iv. Risk of issuing cash receipt for incorrect amount.

2.4.

Learning Outcome: 2.1.3 Assess the business risk connected with sub activities relating to the procurement process.
<u>Missing</u> Quantity/quality acceptable to the particular activity - authorisation <ul style="list-style-type: none">The GRNs are raised for all goods received. There is no process to check whether the ordered goods have been received or whether there are excesses/shortages.
<u>Risks</u> <ol style="list-style-type: none">Acceptance of more or less than ordered.Goods may not be of good quality which will have an impact on production.

2.5.

Learning Outcome: 2.5.2 Assess the business risks connected with sub activities relating to the inventory management process.
Access Restriction - This ensures physical control of the inventory items. - Prevents stealing /misappropriation of inventory items.
Goods Dispatched - Prevents issuing of items to individuals who are not authorized to receive them

2.6.

Learning Outcome: 3.2.1 Explain the importance of operating effectiveness of internal control.
<ol style="list-style-type: none">This ensures timely deliveries of orders.The management will be able to detect any deficiencies related to system operations/processes. E.g. goods delivered but not updated in the system.Evaluates the performance of the suppliers and enables negotiations or selection of a different supplier.Avoids the risk of running out of an important inventory item.

2..7.

<p>Learning Outcome: 3.3.1</p> <p>Explain the importance of IT general controls and application controls in achieving control objectives in a given business process.</p>
<ul style="list-style-type: none"> • Prevents unauthorized amendments to the approved customers and standard prices. • Prevents making sales to unauthorized customers. • Prevents charging inappropriate prices to the customers (No under/over invoicing) • Maintains confidentiality of the price schedule.

2.8.

<p>Learning Outcome: 4.1.1</p> <p>Identify differences between law, ethics and morality.</p>	
<p>Code of conduct</p> <p>Not a law</p> <p>Required behavior of employees by the management</p>	<p>Laws, Regulations</p> <p>It's a law</p> <p>This is a statutory requirement of the legislation of the country</p>
<p>When ethical values are established it drives the individuals/company to comply with legal requirements.</p>	

2.9.

<p>Learning Outcome: 5.3.2</p> <p>Explain the need to conduct an audit in accordance with SLAuS</p>
<ol style="list-style-type: none"> The auditors conduct their audit work to a standard that is considered appropriate and necessary for the purpose of the audit and for reaching an audit opinion. The users of the audited financial statements have the knowledge that the auditor's opinion is based on audit work that has been conducted in accordance with the standards of the audit profession. Enhances public confidence in the external audit as there are standards, according to which the audits should be conducted. It is a statutory requirement for specified business enterprises and limited liability companies.

2.10.

Learning Outcome: 5.1.2	
· Explain the key areas of the assurance framework, including elements, objectives, scope etc.	
Characteristics of appropriate subject matter.	
1. Identifiable -	It must be capable of consistent measurement or evaluation against the criteria that have been identified for the engagement.
2. Collectable -	It must be possible to subject information relating to the subject matter to procedures for gathering, so that sufficient appropriate evidence can be obtained for the purpose of assurance engagement.

(Total: 30 marks)

SECTION 2

Answer 03

Learning Outcome: 1.5.3

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

(a) The internal controls of an organisation reduces the risks at the level of business processes and operations. The purchasing process has many risks. Some of them are:

- i. Selection of wrong supplier
- ii. Placing orders for items not required
- iii. Making payments for materials which are not in good condition.
- iv. Making purchases at higher prices
- v. Frauds and errors

(b) If sound internal controls are established around the purchasing process of the company, these will help to reduce the risks, and will provide reasonable assurance regarding the achievement of objectives in areas such as:

- Effectiveness and efficiency of purchasing – the purchases can be made at the right time at the right price
- Reliability of financial information – the financial statements may be accurate and free of errors
- Compliance with rules and regulations related to purchases

(c) The internal auditor provides management with information and recommendations about internal controls. He does not have a direct responsibility for internal controls.

The internal auditor's responsibility is to investigate control system of Sun Construction PLC as per the annual internal audit plan given, and report the findings to the board/audit committee, with the recommendations.

(d) The board of directors has the final responsibility for the effectiveness of the internal control system of the company

The board is responsible for ensuring that the company has an effective control system. The board should review the design and effectiveness of the system of internal controls.

For this the board can get the help of internal auditors. The board is ultimately responsible to the shareholders.

(Total: 10 marks)

Answer 04

Learning Outcome:	
4.2.2.	Explain integrity, objectivity, professional competence and due care, confidentiality and independence.
4.2.3.	Explain the ethical issues (such as conflict of interest, accepting and making offers) that an accountant may encounter.
(a)	Self-interest threat Self-review threat Advocacy threat Familiarity threat Intimidation threat
(b)	Integrity - Dealing should be straightforward and honest. If I am to agree with the suggestion of sales executive, I am violating 'integrity'. Objectivity - Members shall not allow bias or conflict of interest or undue influence of other people to override their professional or business judgement. Professional behaviour – Members shall comply with relevant laws and regulations (accounting standards) and avoid any action that discredits the profession.
(c)	Self-interest threat – I am getting financial reward if I agree with the sales executive. Safeguard - Commitment as the accountant to ethical behaviour is the only safeguard available. Refuse to accept the suggestion. (Total: 10 marks)

Answer 05

Learning Outcome:	
5.5.2.	Explain the meaning and the difference between test of controls and substantive procedures.
5.5.3.	List different audit procedures used to gather audit evidence.
(a)	<p>Test of controls vs. substantive procedures.</p> <p>Test of controls are tests of the effectiveness of internal controls to prevent misstatements in the financial statements. These are audit procedures designed to evaluate the effectiveness of internal controls in preventing or detecting and correcting material misstatements.</p> <p>Substantive procedures consist of test of details and analytical procedures. These are performed to detect material misstatements in the figures reported in the financial statements.</p> <p>The performance of only test of controls is not sufficient and substantive testing procedures for to pay key balances and transactions should also be performed.</p> <p>If the auditor can rely on the effectiveness of internal controls the need for substantive testing is reduced.</p> <p>However some substantive tastings are also required.</p>
(b)	<ul style="list-style-type: none">- Re-performance- Inspection- Observation- Inquiries
(c)	<p>Sequential order checks - Obtain a list of invoices and it should be checked to make sure the sequential order is always maintained.</p> <p>Approval of invoices - Select a sample of invoices raised during the period and check the evidence of approval by sales manager.</p>
(d)	<p>Substantive procedures on sales</p> <ul style="list-style-type: none">- Sales cut-off- Detailed checking of invoices with source documents- Testing subsequent returns to make sure the sales during the year have in fact occurred- Reconcile sales ledger with the general ledger- Analytical procedure E.g. Ratio, trend analysis
(Total: 10 marks)	

Answer 06

Learning Outcome: 5.5.4 Explain how an auditor considers the relevance and reliability of information to be used as audit evidence.	
(a)	<p>Relevance deals with the logical connection with the purpose of the audit procedures and the assertions under consideration. E.g. checking whether debtors are recoverable by checking subsequent settlement with cash receipts. For this checking supporting documents such as invoices are not relevant. The evidence gathered should also be relevant to the conclusion.</p> <p>Reliability – This is influenced by the source and nature of the information including the control over its preparation and maintenance. E.g. external sources are more reliable than internal, original supporting documents are more reliable than photocopies. The evidence gathered should also be reliable to form the basis for the audit opinion.</p>
(b)	<p>If registration books are missing, Niluka can check the following:</p> <ul style="list-style-type: none">- Insurance policy, emission test and purchase documents of motor vehicles- Revenue license obtained from government authorities (provincial government authorities)- A certified copy of the registration from RMV.
(c)	<p>This creates a <u>doubt as to the price paid for purchases</u> (why photo copy is submitted instead of original). The purchased motor vehicles are smaller cars and the <u>cost seems very high</u>.</p> <p>The original documents may not be available as the company <u>would not have recorded the correct value with</u> the intention of reflecting high value of assets.</p>
(d)	<p>Professional skepticism The auditor <u>must plan and perform an audit with an attitude of professional skepticism</u>, recognizing that circumstances may exist that causes the financial statements to be materially misstated. Professional skepticism <u>is an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud</u>, and a critical assessment of audit evidence.</p> <p style="text-align: right;">(Total: 10 marks)</p>

SECTION 3

Answer 07

Learning Outcome: 2.4.2. Assess the business risks connected with sub activities relating to PPE management process. 2.5.2 Assess the business risks connected with sub activities relating to the inventory management process.	
(a)	<p>Packing equipment – These are not very heavy (as stated in the scenario) and are portable. Therefore, there is a risk of theft (risk of physical access and need for physical controls). Risk of high maintenance cost as machinery is old.</p> <p>The assets were purchased some time back. Therefore, new assets may need to be purchased. The management needs to be aware of the provisions in CAPEX budget to facilitate the new purchases.</p> <p>There is a risk of disposing of the assets without proper authorization. The correct disposal price may not be received.</p> <p>Any damages, theft of items are not properly identified and these may not have been properly reflected in the accounts (reconciliation of general ledger with FAR).</p> <p>Motor vehicles – There is a risk of using the vehicles for other use other than the intended use.</p> <p>The risk of meeting with accidents, damages to the vehicles and damages to public, other properties (both public and personal).</p>
(b)	<p>Fixed Asset Register (FAR) can be used in carrying out physical verification of fixed assets. If a FAR is available it helps to:</p> <ul style="list-style-type: none">- Identify the assets (as coding is available)- Identify the location of the asset- Identify any asset losses (the asset may reflect in FAR but not be available physically)- Identify existence of fixed assets
(c)	<ul style="list-style-type: none">- Excessive costs in delivering goods from stores to operational units around the country- Physical risks to inventory – the risk of theft and damages- Risk of running out of inventory items – if the system is not properly updated, the management may not know the point at which orders should be placed to buy tea.- Risk of excessive inventory levels (some items are not moving)- Risk of errors in inventory records

- (d)
- Establish a cut-off time
 - Details of counted stock items should be recorded on count sheets
 - These should be sequentially numbered in advance of the count.
 - In each count team, one person identifies and counts the inventory item and another person records the details on a count sheet. Segregation of duties
 - Counted items should be marked to reduce the risk of double counting
 - At the end of counting, each count team returns its completed count sheets to the manager in charge
- Details on the count sheets should be recorded to produce totals for each item of inventory

(e) The slow moving items may indicate that the sales have come down or sales prices may have been affected. Since there is an expiry date, if the items concerned do not move, it will result in obsolescence of products.

It is understood presently the inventories are carried at cost. LKAS 2 requires the inventories to be valued at the lower of cost or NRV. Therefore, the current situation may indicate that cost exceeds the NRV. Therefore, the management needs to consider NRV, taking into consideration the estimated selling price and costs to be incurred to sell the products. If the NRV is lower than the cost, the management needs to value the inventories at NRV.

(Total: 20 marks)

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