

CA



THE INSTITUTE OF  
**CHARTERED** ACCOUNTANTS  
OF SRI LANKA

# **SUGGESTED SOLUTIONS**

**KE4 – Processes, Assurance & Ethics**

**September 2017**

## SECTION 1

### Answer 01

1.1

<b>Learning Outcome/s: 1.1.2</b>
Identify the key business processes in a business organisation.
Study text reference: Pages 12 and 13
<b>Correct answer: B</b>

1.2

<b>Learning Outcome/s: 1.3.1</b>
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).
Study text reference: Page 32
<b>Correct answer: B</b>

1.3

<b>Learning Outcome/s: 1.5.1</b>
Define the system of internal control.
Study text reference: Page 50
<b>Correct answer: D</b>

1.4

<b>Learning Outcome/s 2.1.3</b>
Assess the business risk connected with sub activities relating to the procurement process.
Study text reference: Page 108
<b>Correct answer: A</b>

1.5

<b>Learning Outcome/s: 2.2.2</b>
Identify the documents relating to the payroll process, point of origination, flow of documents and purpose.
Study text reference: Page 120
<b>Correct answer: B</b>

1.6

<b>Learning Outcome/s: 2.3.1</b>
Identify activities connected with the cash management process, such as maintenance of cash book, petty cash book, bank reconciliations, investments etc.
Study text reference: Page 140
<b>Correct answer: A</b>

1.7

<b>Learning Outcome/s: 2.6.3</b>
Limitations of internal control.
Study text reference: Page 10
<b>Correct answer: A</b>

1.8

<b>Learning Outcome/s: 3.2.1</b>
Explain the importance of operating effectiveness of internal control
Study text reference: Pages 228 – 230
<b>Correct answer: C</b>

1.9

<b>Learning Outcome/s: 3.3.1</b>
Explain the importance of IT general controls and application controls in achieving control objectives in a given business process.
Study text reference: Page 235
<b>Correct answer: D</b>

1.10

<b>Learning Outcome/s: 4.1.1</b>
Identify differences between law, ethics and morality.
Study text reference: Page 249
<b>Correct answer: A</b>

**(Total: 20 marks)**

## Answer 02

### 2.1

<b>Learning Outcome/s: 2.3.2</b>
Identify documents relating to cash management (receipts, payment vouchers, etc.) point of origination, flow of documents and purpose.
Study text reference: Page 135
<ul style="list-style-type: none"><li>• It is the book where receipts and payments of cash are initially recorded (book of prime entry).</li><li>• It provides control over recording of all receipts and payments.</li><li>• It provides a summary of all receipts and payments, thereby providing management information in a timely manner.</li><li>• It is also an account in the double entry bookkeeping system (general ledger account e.g. to ascertain the balance available at a given time).</li></ul>

### 2.2

<b>Learning Outcome/s: 1.2.1</b>
Define the term "risk".
Study text reference: Page 27
Negative risks are risks where the possible outcome may be adverse and worse than expected, and will not be more favorable than expected Strategic risks are risks where the possible outcome may be either better or worse than expected.

### 2.3

<b>Learning Outcome/s: 2.1.1</b>
Identify activities connected with the procurement process, such as: <ul style="list-style-type: none"><li>▪ Vendor selection and evaluation</li><li>▪ Budgetary controls</li><li>▪ Placing orders</li><li>▪ Receiving</li><li>▪ Payment</li></ul>
Study text reference: Page 76
<ul style="list-style-type: none"><li>• Supplier selection</li><li>• Placing orders (within budget limits)</li><li>• Receiving delivery of goods</li><li>• Paying the supplier</li></ul>

## 2.4

<b>Learning Outcome/s: 2.5.2</b>
Assess the business risks connected with sub-activities relating to the inventory management process.
Study text reference: Page 217
<ul style="list-style-type: none"> <li>• An increase in costs or a fall in selling price</li> <li>• A physical deterioration in the condition of inventory</li> <li>• Obsolescence of products</li> <li>• A decision as part of the company's marketing strategy to manufacture and sell products at a loss</li> <li>• Errors in production/costing or purchasing</li> </ul>

## 2.5

<b>Learning Outcome/s: 2.6.1</b>
Identify activities connected with the sales process, such as order acceptance, credit evaluation, delivery, invoicing, recording and settlement of receivables.
Study text reference: Page 5
<ul style="list-style-type: none"> <li>- Data identifying the seller (supplier) and the buyer</li> <li>- Reference to the invoice</li> <li>- Number/quantity and description of the products</li> <li>- Date of issue of the document and date of delivery of the goods</li> <li>- Name, signature and stamp of the purchaser accepting delivery of the goods in good condition.</li> </ul>

## 2.6

<b>Learning Outcome/s: 3.4.1</b>
Explain deficiencies in internal controls in a given business process.
Study text reference: Page 238
<p>(a)</p> <ul style="list-style-type: none"> <li>(i) Not applying/practicing the controls</li> <li>(ii) Oversight of the control</li> <li>(iii) Ignorance of the control</li> </ul> <p>(b) A consequence is that the production process may get disrupted due to machinery breakdowns resulting from not having regular maintenance.</p>

2.7

<b>Learning Outcome/s: 2.3.3</b>
Assess the business risks connected with sub-activities relating to the cash management process.
Study text reference: Page 140
<ul style="list-style-type: none"><li>• Daily totals of receipts in the cash book should be compared with the total value of cash and cheques banked (deposited) and the money received by bank transfers.</li><li>• Bank reconciliations should be made regularly to compare the balance in the cash book with the bank account balance.</li><li>• Segregation of duties in raising the cash receipts and recording there of and the person checking the accuracy of the cash book.</li></ul>

2.8

<b>Learning Outcome/s: 4.2.2</b>
Explain integrity, objectivity, professional competence and due care, confidentiality and independence.
Study text reference: Page 256
<ul style="list-style-type: none"><li>• Maintain their professional knowledge and skills at the level required to ensure that the employers receive a competent, professional service.</li><li>• Act diligently, in accordance with applicable technical and professional standards when providing professional services.</li></ul>

2.9

<b>Learning Outcome/s: 5.1.1</b>
Explain the concept of assurance.
Study text reference: Pages 272 – 274
External audits consist of the following features relevant to an assurance engagement: <ul style="list-style-type: none"><li>• The auditor/practitioner expresses a conclusion/opinion (positive form/true and fair view).</li><li>• There is a three-party relationship in an external audit engagement i.e. auditor/practitioner, management, shareholders. It is intended to enhance the degree of confidence of the intended user.</li><li>• The audit opinion is expressed on the financial statements, which is the subject matter.</li><li>• One opinion is expressed by applying certain criteria to the subject matter (SLASs).</li><li>• Evaluation or measurement of the subject matter.</li></ul>

<b>Learning Outcome/s: 5.5.1</b>
<p>Explain the concepts and meanings of:</p> <ul style="list-style-type: none"> <li>▪ Sufficient and appropriate audit</li> <li>▪ The nature, timing and extent of audit procedure</li> </ul>
Study text reference: Page 303
<p>'Sufficiency' and 'appropriateness' are interrelated and apply to both tests of controls and substantive procedures.</p> <ul style="list-style-type: none"> <li>• Sufficiency is the measure of the quantity of audit evidence.</li> <li>• Appropriateness is the measure of the quality or reliability of the audit evidence.</li> </ul> <p>The quantity of audit evidence required is affected by the level of risk in the area being audited. It is also affected by the quality of evidence obtained. If the evidence is of high quality, the auditor may need less evidence than if it were of poor quality. However, obtaining a high quantity of poor quality evidence will not cancel out its poor quality.</p>

**(Total: 30 marks)**

## SECTION 2

### Answer 03

<b>Learning Outcome/s: 1.8.1 and 1.9.1</b>
1.8.1 Identify the governance structure of a business organisation.
1.9.1 Identify who is responsible for the introduction of controls in an organisation
Study text reference: Pages 66 – 68

- (a) The board of directors is responsible for ensuring that the company has an effective internal control system.
- (b) Areas of responsibility for management:
- Introduce controls to an organisation.
  - Approve the design of controls.
  - Ensure that controls are implemented properly.
  - Ensure that control information is communicated to relevant persons.
  - Review the effectiveness of controls and report to the audit committee or the board.
- (c) External and internal auditors provide management with information and recommendations about internal controls, but they do not have direct responsibility for internal controls.

External auditors consider the effectiveness of internal controls, as part of the annual audit process. They should report to the audit committee about any weaknesses in internal financial controls that they discover. However, the external auditors do not have direct responsibility for internal controls.

Internal auditors investigate control systems and report to the management, the audit committee or the board about their findings and recommendations. However, internal auditors do not have any responsibilities for internal controls.

**(Total: 10 marks)**



## Answer 04

Learning Outcome/s: 4.2.1 and 5.1.2
4.2.1 State the importance of ethical behaviour for a professional accountant. 5.1.2 Explain the key areas of the assurance framework, including elements, objectives, scope etc.
Study text reference: Pages 252 and 277

- (a) There are various reasons why accountants should behave ethically.
- (i) Other people rely on the accuracy of the financial statements produced by accountants. Published financial statements should give a true and fair view of the financial performance and position of a company, so that the company owners (shareholders) can take informed decisions about their investment. Governments also require honest financial statements and accounting records to ensure that businesses pay the correct amount of tax that they owe.
  - (ii) The client has sought the accounting advice of an accountant, as the client believes he/she has the required expertise in these areas. In order to meet the client's expectations, the accountant needs to have the appropriate knowledge about the accounting standards and expertise in the areas to do the work competently.
- (b) (i) The assurance engagement must have an appropriate subject matter. Appropriate subject matter for an assurance engagement should be 'identifiable' and 'collectable'.
- It can take many forms including:
- Financial performance (e.g. historical financial information)
  - Non-financial performance (e.g. key performance indicators)
  - Physical characteristics (e.g. capacity of a product facility)
  - Systems and processes (e.g. internal controls)
  - Behaviour (e.g. compliance with laws and regulations)
- (ii)
- Relevance (relevant to the purpose for which the intended users require the information)
  - Completeness
  - Reliability
  - Neutrality (freedom from bias)
  - Understandability

**(Total: 10 marks)**

## Answer 05

<b>Learning Outcome/s: 5.5.4 and 2.1.2</b>	
5.5.4	Explain how an auditor considers the relevance and reliability of information to be used as audit evidence.
2.1.2	Identify the documents relating to procurement cycle, point of origination, flow of documents and purpose.
Study text reference: Pages 89 and 303	

(a)

(i)

- Relevance deals with the logical connection with the purpose of the audit procedure and the assertion under consideration.
- Reliability is influenced by the source and nature of the information, including the controls over its preparation and maintenance.

(ii)

<b>Audit procedure</b>	<b>Reliability</b>
Check sales invoices and delivery notes	This is an internal source and the level of reliability is less than external confirmations <b>OR</b> Delivery notes when signed by recipient, may provide external audit evidence. However, it may be difficult to establish who signed it unless a seal is chopped.
Call for direct confirmations from debtors	External sources are likely to be more reliable than internal sources

(b)

<b>Internal control checks</b>	<b>Control objective</b>
The invoice is checked against the GRN and the purchase order	To make sure that the correct goods have been delivered, in the correct quantities and that the supplier is invoicing for the correct price.
The invoice details are checked.	An arithmetical check to make sure that the invoiced amount is correct. This is necessary when invoices are not computer-produced.
Invoice should be formally approved for payment.	To prevent improper payments.
The person checking and recording the invoice details is not the same person who makes the payment to the supplier.	Segregation of duties → this is to reduce the risk of a person making an incorrect (fraudulent) payment.

**(Total: 10 marks)**

## Answer 06

Learning Outcome/s: 5.5.2 and 5.5.3	
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.
Study text reference: Pages 304 – 306, 313	

- (a) Tests of controls are audit procedures designed to evaluate the effectiveness of internal controls in preventing or detecting and correcting material misstatements at the assertion level.

On the other hand, substantive testing is carried out on material items. These are the procedures for checking the information (assertions) in the financial statements. Substantive testing is an audit procedure that should always be carried out in an audit. It is performed to detect material misstatements in the figures reported in the financial statements. There are two types under this; one is test of details and the other is substantive analytical procedures.

Substantive testing is different from tests of controls, which are tests of the effectiveness of controls, not tests of financial statement assertions. Some substantive testing must always be carried out in an audit. On the other hand, performing of tests of controls is not always a must. The extent of substantive testing will depend on the strength of the internal controls and the results of the auditor's tests of controls. Substantive testing is designed to provide evidence about the assertions that are made in the financial statements.

(b)

- Observe the inventory count done by the company's warehouse staff.
- Carry out some inspection (sample count) to trace items in the inventory list to the physical items in the warehouse.
- Add the total value of the items in the list of inventory held at the year-end, to make sure that it agrees with the figure in the financial statements.
- For each item in the list, multiply the quantity by the lower of cost or selling price, and compare this with the valuation given to the item by the company. Investigate any significant differences with the company's year-end valuation.
- Carry out a check on the provision that the company has made for obsolete inventory. Check for items whose last date of purchase was, say, four months ago and items where the most recent date of sale was, say, four months ago. These checks may indicate the need for inventory to be written down in value.

**(Total: 10 marks)**

## SECTION 3

### Answer 07

Learning Outcome /s: 2.1.1, 2.1.3, 2.4.1 and 2.4.2	
2.1.1. Identify activities connected with the procurement process, such as:	<ul style="list-style-type: none"> <li>• Vendor selection and evaluation</li> <li>• Budgetary controls</li> <li>• Placing orders</li> <li>• Receiving</li> <li>• Payment</li> </ul>
2.1.3 Assess the business risk connected with sub-activities relating to the procurement process.	
2.4.1 Identify activities connected with PPE management, including:	<ul style="list-style-type: none"> <li>• CAPEX budgeting and approval</li> <li>• Vendor selection and tender procedures</li> <li>• Capitalisation and depreciation</li> <li>• Fixed assets register</li> <li>• Physical controls</li> <li>• Disposal</li> </ul>
2.4.2 Assess the business risks connected with sub-activities relating to the PPE management process.	
Study text reference: Pages 99, 97, 80, 177 and 182	

(a) (i)

Issue	Documentary evidence
1	References from other customers of the supplier.
2	Obtain financial information from the supplier, such as a copy of their financial statements.
3	Quality certification of goods such as ISO/SLS or any other quality accreditation. Reference from other customers.
4	Confirmation in writing that they do not use child labour and provide reasonable working conditions for employees. Obtain code of conduct/policies established.

- (ii)
- From knowledge of the industry
  - Recommendations from other users of the supplier
  - Being approached by sales representatives of suppliers
  - Through the Internet
  - By media such as newspapers, trade magazines, journals and directories
  - By attending trade fairs and exhibitions

(iii)

- (1) The supplier is unable to provide the goods or cannot provide goods to the required quality.
- (2) Goods are ordered from non-existent suppliers (fraud).

(b) (i)

- Building/Other assets: Damage to the building and thereby pose risk of illegal entry to the building and factory premises.
- Other assets such as machinery, other electrical systems and motor vehicles are all liable to break down and accidents.
- The entity has small moveable items that are non-current assets. These could be stolen if not properly protected.

(ii)

<b>Risk</b>	<b>Physical control</b>
Building – damage to the building and risk of illegal entry to the building and factory premises.	Strong locks on doors, protection of windows against breakage, burglar alarms, fire alarms, CCTV cameras, security guards, insurance policies.
Other assets such as machinery, other electrical systems and motor vehicles are all liable to break down.	Protection against the risk of breakdown should be provided by regular maintenance.
The entity has small moveable items that are non-current assets. These could be stolen if not properly protected.	These should be kept in a secure place, such as a lockable place, when not being used. When employees take non-current assets such as laptops away from the office, they should be required to sign a document as evidence that they are in possession of the asset, or monitor the physical access through CCTV cameras.

(iii) Physically identification of non-current assets:

- A **manual sticker** may be pasted to each fixed asset, containing the asset's unique identification number.
- A **barcode label** may be attached to each fixed asset, containing data that identifies the individual asset, including its unique identification number.
- Assets may also be identified using **radio-frequency identification (RFID) tags**.
- Motor vehicles → vehicle registration or chassis number.
- Other equipment (laptops, desktops etc.) → serial number

**(Total: 20 marks)**

## Notice of Disclaimer

The answers given are entirely by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) and you accept the answers on an "as is" basis.

They are not intended as "Model answers", but rather as suggested solutions.

The answers have two fundamental purposes, namely:

1. to provide a detailed example of a suggested solution to an examination question; and
2. to assist students with their research into the subject and to further their understanding and appreciation of the subject.

The Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) makes no warranties with respect to the suggested solutions and as such there should be no reason for you to bring any grievance against the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka). However, if you do bring any action, claim, suit, threat or demand against the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka), and you do not substantially prevail, you shall pay the Institute of Chartered Accountants of Sri Lanka's (CA Sri Lanka's) entire legal fees and costs attached to such action. In the same token, if the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) is forced to take legal action to enforce this right or any of its rights described herein or under the laws of Sri Lanka, you will pay the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) legal fees and costs.

---

© 2013 by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka).

All rights reserved. No part of this document may be reproduced or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without prior written permission of the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka).

---