

CA



THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

KE4 – Processes, Assurance & Ethics

March 2018

SECTION 01

Answer 01

1.1

Learning Outcome/s: 1.5.3 Identify the role of the internal control system in an entity in mitigating risk at the business process level.
Study text reference: page 51
Correct Answer: A

1.2

Learning Outcome/s: 2.5.1 Identify activities connected with the inventory management process, such as : <ul style="list-style-type: none">- Designing optimum order quantities- Physical safeguard of inventory- Receiving- Issuing goods, etc.
Study text reference: Page 68 of Additional study support material
Correct Answer: C

1.3

Learning Outcome/s: 1.6.2 Explain the role of the information system and communications system within the overall internal control system of an entity.
Study text reference: page 62-63
Correct Answer : B

1.4

Learning Outcome/s: 3.1.1 Recognise the importance of design effectiveness of control in achieving the objectives of a given business process.
Study text reference: page 231
Correct Answer : C

1.5

Learning Outcome/s: 2.1.1 Identify activities connected with the procurement process, such as Vender Selection and evaluation, etc.
Study text reference: page 79-80
Correct Answer : B

1.6

Learning Outcome/s: 2.4.2

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

Study text reference: page 182

Correct Answer: B

1.7

Learning Outcome/s: 2.6.1

Identify activities connected with the sales process, such as order acceptance, credit evaluation, delivery, invoicing, recording and settlements of receivables.

Sales management: page 3

Correct Answer: D

1.8

Learning Outcome/s: 4.2.1

State the importance of ethical behaviour for a professional accountant.

Study text reference: page 253

Correct Answer: C

1.9

Learning Outcome/s: 5.1.1

Explain the concept of assurance.

Study text reference: page 273

Correct Answer : B

1.10

Learning Outcome/s: 5.4.2

Identify factors that affect auditors' judgment as to what constitutes sufficient appropriate evidence.

Study text reference: page 303

Correct Answer : A

(2 x 10 = Total: 20 marks)

Answer 02

2.1

Learning Outcome/s: 1.1.3
Define the elements of external environment that affect business organisations such as political, legal technological, economic, etc.
Study text reference: page 8 of additional study support material
<ul style="list-style-type: none">• Wastage handling methods• Organization's policy for environmental protection• Effectiveness of energy consumption method used by an entity• Environmental factors relating to weather, climate and geographic location

2.2

Learning Outcome/s: 1.2.2
Define "enterprise risk management".
Study Text reference: page 26-27
Risk is the possibility that results will differ from what was expected and this will affect the ability of the organization to achieve its objectives. Organizations are exposed to many different risks, some much more significant than others. Significant risks could cause significant losses, and even threaten the future of the business. Therefore, risks to be managed and kept within acceptable limits.

2.3

Learning Outcome/s: 1.6.1
Explain the main control activities such as:
<ul style="list-style-type: none">- Segregation of duties- Physical controls- Authorisation- Business performance review- Information processing controls
Study text reference: page 58
Segregation of duties – Duties should be separated between two or more people. This means that the same person is unable to perform two key tasks and also that one person acts as a check on what another person has done.
For an example, Petty cash voucher is prepared by the petty cashier and authorized by the accountant.
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2.4

Learning Outcome/s: 1.7.1

Discuss the inherent limitations of an internal control system.

Study text reference: page 230

- The potential for human error
- Collusion between employees
- Management over-ride/by-pass of controls
- Software failure/successful hacking

2.5

Learning Outcome/s: 2.1.2

Identify the documents relating to the procurement cycle, point of origination, flow of documents and purpose.

Study text Reference: page 82-83

Document – Purchase requisition form

Purpose – It is the formal request for the purchase of a quantity of a specified item. The purchase requisition is used by the purchasing department as an authority to place a purchase order with a supplier.

2.6

Learning Outcome/s 2.4.2

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

Study text reference: page 182

- Acquisition of non-current assets without proper authorization or in excess of the organization's ability to finance
- Disposal of non-current assets without proper authorization
- Theft, loss or damage
- The risk that non-current assets cannot be found or do not exist
- The risk that the accounting records for non-current assets are incorrect

2.7

Learning Outcome/s: 2.6.2

Identify the documents relating to sales processes, point of origination, flow of documents and purpose.

Study Support Material : page 4-6 – Business Processes – Sales Management

- The Sales order - is an internally generated document that a company sends to a customer as a confirmation of purchase order
- Delivery note - The delivery note is a document that certifies the delivery of goods to the buyer. The buyer will sign the delivery note to confirm that the goods have been delivered in accordance with the conditions established
- Sales invoice - A sales invoice can be defined as the request of payment from customer for goods sold or services provided by the seller.

2.8

Learning Outcome/s 3.3.1

Explain the importance of IT general controls and application controls in achieving control objectives in a given business process.

Study text reference: page 234

Many general IT controls are procedural in nature. They help to create risk awareness in all IT applications. They are also necessary to ensure that IT applications are implemented with limited risks.

Application controls are largely controls written into the application software, to check for errors, and report (or automatically correct) errors that are detected. Just as human error may have a serious impact in manual systems, software errors in processing may corrupt an IT system.

2.9

Learning Outcome/s: 4.1.1

Identify differences between law, ethics and morality.

Study text reference: page 248-249

Laws and regulations – These establish ways in which the government requires us to behave

Ethics – These establish ways that members of an organisation or professional are required to behave. Ethical standards should include compliance with laws and regulations, but extend into aspects of behavior that are not governed by laws

Morality – These are a personal sense of right and wrong and how the individual should behave. Individuals may consider some ethical standards, laws and regulations to be 'wrong'.

Learning Outcome/s 5.3.2**Explain the need to conduct an audit in accordance with SLAuS.****Study text reference: page 296**

- The 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.
- The users of audited financial statements have the knowledge that the auditors' audit opinion is based on audit work that has been conducted in accordance with the standards of the audit profession.

(Total: 30 marks)

SECTION 2

Answer 03

Relevant Learning Outcome/s: 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)

Study text reference: page 28, 40

(a)

- i. Strategic risk
- ii. Operational risk
- iii. Operational risk
- iv. Fraud risk

(b)

- 1. Risk avoidance
- 2. Risk transfer
- 3. Risk acceptance
- 4. Risk reduction

(Total: 10 marks)

Answer 04

Relevant Learning Outcome/s:

- 3.1.1 Recognise the importance of design effectiveness of control in achieving the objectives of a given business process.
- 4.2.3 Explain the ethical issues (such as conflict of interest, accepting and making offers) that an accountant may encounter.

Study text reference: pages 228 to 231 and 257

(a)

- Inappropriate review of Bank Reconciliations
- Inability to provide explanations after review.
- Based on reconciling items, action may be required to be taken to investigate the items and it appears such action have not been taken.
- Unavailability of bank reconciliation means either it is not prepared or reviewed.
- Not being able to locate the bank reconciliation statement means a lapse in record keeping function.

(b)

(i) **Ethical issues faced**

1. Nuwan has noted a need for a provision on impairment. He might be able to avoid making the provision considering the financial benefit he has to forego by doing that. Therefore in this case, Nuwan is facing the threat of self-interest and will result in a violation of fundamental principles on ethics.
2. In this scenario, Nuwan will be faced with the **Intimidation threat** as he is expected to create a bogus supplier in the system. The general manager has threaten Nuwan saying that he will provide negative feedback on his performance to the Board of Directors if he does not create this supplier in the system.

(ii) **Fundamental principles of the Code of Ethics**

- Integrity
- Objectivity
- Professional competence and due care
- Confidentiality
- Professional behavior

(Total: 10 marks)

Answer 05

Relevant Learning Outcome/s:

5.1.2 Explain the key areas of the assurance framework, including elements, objectives, scope etc.

5.2.1 Explain situations where assurance services can be rendered by a practitioner.

Study text reference: page 273 to 278, 285

- (a) (i) There is a three-party relationship - The three parties are:
- The intended user of the information - Stakeholders
 - The accountant (practitioner)
 - The person providing the information - Management (the responsible party)
- (ii) Subject matter – Financial statements prepared in accordance with an accounting framework.

(b)

Economy – Obtaining the appropriate quantity and quality of physical, human and financial resources (inputs) at lowest cost.

Efficiency – the relationship between goods or services produced (outputs) and the resources used to produce them. An efficient operation produces the maximum output for any given resources of input.

Effectiveness – is concerned with how well an activity is achieving its policy objectives or other intended objectives

(Total: 10 marks)

Answer 06

Relevant Learning Outcome/s
- Sufficient and appropriate audit evidence
- The nature, timing and extent of audit procedures
5.5.2 Explain the meaning and the difference between test of controls and substantive procedures.
Study text reference: page 303 to 306

- (a) (i) Since this land is for the own use of the company, and as the decisions made by the board of directors are documented in the minutes available, as the auditor, I will review the relevant board meeting minute to support the management intended use of this land.

Since this land will be classified as own land, in order to verify the ownership, the deed of the land will be inspected.

- (ii) Inspect the motor vehicle registration documents. Insurance documents, revenue license etc. to confirm the ownership, and inspect the physical existence. Inspect the invoices from the supplier, custom documents for the custom duty paid and clearance to verify the amount capitalised.

- (iii) Since this litigation might have an impact on the financial statements (either will be disclosed in the financial statements or provided for the claim). As the auditor, I have to corroborate the management view. For that a request will be made to the legal counsel who is involved in the litigation on behalf of the client, who will be required to confirm the status and possible outcome of the litigation or review of any legal correspondence for this litigation in a letter. Further, I will obtain a letter of representation from the board of directors regarding their view on the litigation.

(b) **Difference between test of controls and substantive audit procedures**

Test of controls	Substantive audit procedures
Audit procedures designed to evaluate the effectiveness of internal controls in preventing, detecting and correcting material misstatement at the assertion level. (effectiveness of controls)	Procedures for checking the information in the financial statements (financial statement assertions)
Performance of test of controls depends on the operating effectiveness of the controls.	The extent of substantive audit procedures will depend on the strength of internal controls and the results of the auditor's test of controls. If the auditor can rely on effectiveness of the internal controls, the need for substantive testing is reduced.
Carrying out of test of controls are not mandatory and always not possible	The auditor shall always carry out substantive procedures on material items. Irrespective of the assessed risk of material misstatement, the auditor should design and

Test of controls	Substantive audit procedures
	perform substantive procedures for each material class of transactions, account balances and disclosures
Manual or automated controls can be tested through test of controls	Substantive audit procedures consist of: <ul style="list-style-type: none"> - Test of details - Substantive analytical procedures

(Total: 10 marks)

SECTION 3

Answer 07

Relevant Learning Outcomes/s	
2.6.1	Identify activities connected with the sales process, such as order acceptance, credit evaluation, delivery, invoicing, recording and settlement of receivables.
2.6.3	Assess the business risk connected with activities related to the sales and receivable process.
2.3.1	Identify activities connected with the cash management process such as recruitment, preparation and payment of salaries.
Study text reference: pages 134-142, Study support material 1-12	

(a) Control weakness	(b) Risk
Marketing Assistant is authorized to adjust rates	Prices may be quoted lower than the cost
Sales invoices are not serially pre-numbered	Incomplete/ inaccurate recognition of sales
Invoices and quotations are not approved by an authorized person before sending, as duties are not segregated	Under/ over invoicing or duplicate invoicing, frauds and errors.
Invoices are based only on the customer agreed rates and subsequent information are not considered if any. There could be additional charges to be included due to changes to the initially agreed tour packages as customers tend to change the routes with an agreement of the coach drives.	Under/ over invoicing

(c)

- Adjustments to standard rates have to be approved by an authorized person
- Sales invoices should be serially pre numbered and pre-printed invoice books have to be used instead of computer printouts, in the absence of an automated invoicing system
- Invoices and quotations should be prepared by a one person and approved by another person
- Subsequent changes should be agreed by both parties, confirmed with the driver, recorded and considered in invoicing.

(d)

Lapse
Cash is banked daily.
Collection summaries are not compared with the sales invoices/ sales summaries for the relevant period
Deposit slips are not sent along with the collection summaries and therefore not checked against each other
Cash is held at branches for 3 days in a drawer/ cash box/ cash register
Copies of the Receipts are not available/not sent to Head Office along with the collection summaries.
Cash book is updated based on a collection summary sent by the branch.

(Total: 20 marks)

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