

CA



THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

KE4 – Processes, Assurance & Ethics

March 2019

SECTION 1

Answer 01

1.1

Learning outcome/s: 1.1.1

Identify the different types of business organisations and their objectives.

Study text reference: Page 7

Correct answer: B

1.2

Learning outcome/s: 1.1.3

Define the elements of the external environment that affect business organisations, such as political, legal technological, economic etc.

Study text reference: Pages 15 – 19

Correct answer: C

1.3

Learning outcome/s: 1.2.1

Define the term "risk".

Study text reference: Pages 27 and 28

Correct answer: B

1.4

Learning outcome/s: 2.1.2

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

Study text reference: Pages 82 and 83

Correct answer: D

1.5

Learning outcome/s: 2.2.1

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

Study text reference: Pages 127 and 128

Correct answer: D

1.6

Learning outcome/s: 4.2.3

Explain the ethical issues (such as conflict of interest, accepting and making offers) that an accountant may encounter.

Study text reference: Page 260

Correct answer: D

1.7

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 235

Correct answer: D

1.8

Learning outcome/s: 2.6.1

Credit acceptance.

Study text reference: Page 12 (additional study support material)

Correct answer: C

1.9

Learning outcome/s: 5.1.2

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

Study text reference: Page 279

Correct answer: A

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: B

(2 x 10 = Total: 20 marks)

Answer 02

2.1

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 32

- Fraud risk
- Compliance risk (health regulations)
- Reputational risk
- Mistakes by employees
- Failure to perform procedures correctly
- Breakdown of equipment
- Failing to handle customer complaints properly

2.2

Learning outcome/s: 1.8.1

Identify the governance structure of a business organisation.

Study text reference: Page 68

The external auditor considers the effectiveness of internal financial controls as part of the annual audit process. They report to management and the audit committee about any weaknesses in the internal financial controls that they discover. However, the external auditor does not have direct responsibility for internal controls.

2.3

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 50

Internal controls are designed to provide reasonable assurance regarding the achievement of objectives in the following areas.

1. Reliability of financial reporting
2. Effectiveness and efficiency of operations
3. Compliance with applicable laws and regulations

2.4

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

To overcome this problem companies may establish a whistleblowing system that enables employees to report wrongdoings by colleagues or managers in confidence to an independent person. A whistleblowing system is therefore a form of internal control that seeks to reduce the risk that information about wrongdoings by employees will go unreported and undetected.

2.5

Learning outcome/s: 2.3.1

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

Study text reference: Page 140

- To check whether the balance in the cash book and the balance in the bank's records agree.
- To identify errors or omissions in the cash book.
- To identify possible mistakes made by the bank/management.
To use as a control procedure to ensure that all payments from the bank account are properly accounted for and the accounting records for cash are correct.

2.6

Learning outcome/s: 2.4.1

Identify activities connected with PPE management, including:

- CAPEX budgeting and approval
- Vendor selection and tender procedures
- Capitalisation and depreciation
- Fixed assets register
- Physical controls
- Disposal

Study text reference: Page 169

- The chosen vendor may have more experience in the type of work that is the subject of the contract.
- The chosen vendor may be able to deliver the equipment within a shorter period of time.
The chosen vendor may have a good track record of providing such a specialised plant to other entities.

2.7

Learning outcome/s: 2.6.3

Business risk in the sales process.

Study text reference: Page 11 (additional study support material)

- Invoices should be checked by one person and approved by another person.
- Invoicing should be computerised.
- Invoices should be serially pre-numbered.
Monthly statements should be sent to customers to get the balance confirmed.

2.8

Learning outcome/s: 3.4.1

Explain deficiencies in internal controls in a given business process.

Study text reference: Pages 237 – 239

- Petty cash payments – A maximum limit is set to have control over payments and minimise the impact of fraud. Making payments in two tranches to avoid the maximum limit for petty cash payments. This will lead to misappropriation of assets/cash of the entity.
- No specific petty cash float. Hence, fraud committed may not be identified in a timely manner. Issuing a cash cheque for Rs. 25,000 instead of issuing a crossed cheque in favour of the supplier will give room for theft of cash.

2.9

Learning outcome/s: 4.2.3

Explain the ethical issues (such as conflict of interest, accepting and making offers) that an accountant may encounter.

Study text reference: Page 259

The principle of confidentiality imposes an obligation on a professional accountant to refrain from:

- (a) Disclosing to anyone outside the firm any confidential information without proper and specific authority.
- (b) Using confidential information to their personal advantage or the advantage of a third party.

Confidentiality is an important fundamental ethical principle but there are circumstances in which the law allows or requires confidentiality to be breached, such as the following.

- Where disclosure is permitted by law and is authorised by the client or employer e.g. Companies Act, Sri Lanka Accounting Standards.
- Where disclosure is required by law e.g. to provide documents or other evidence for legal proceedings.

2.10

Learning outcome/s: 5.5.1

Explain the concepts and meanings of:

- Sufficient and appropriate audit evidence
- The nature, timing and extent of audit procedures

Study text reference: Pages 279 and 303

- An assurance practitioner reaches an opinion on the basis of the evidence that they are able to gather. The evidence available to the assurance practitioner must be sufficient; that means there should be a large enough quantity of evidence. The quality of evidence depends on the risk of the subject matter being materially misstated by its preparer. However, the quality of evidence depends on the quantity too. When audit evidence is very reliable, less evidence may be required.
- Assessment of risk at the financial statement level and/or the individual transaction level – as the risk increases, then more evidence is required.
- Materiality of the item – more evidence will normally be collected on material items whereas immaterial items may simply be reviewed to ensure they appear materially correct.
- Nature of the accounting and internal control systems – the auditor will place more reliance on good accounting and internal control systems, limiting the amount of audit evidence required.
- Auditor’s knowledge and experience of the business – where the auditor has good past knowledge of the business and trusts the integrity of the staff, then less evidence will be required.
- Findings of audit procedures – where findings from related audit procedures are satisfactory (e.g. tests of controls over revenue), then less substantive evidence will be collected.
- Source and reliability of the information – where evidence is obtained from reliable sources (e.g. written evidence), then less evidence is required than if the source was unreliable (e.g. verbal evidence).

(Total: 30 marks)

SECTION 2

Answer 03

Learning outcome/s: 2.4.1 and 2.3.3

2.4.1 Identify activities connected with PPE management, including:

- Capex budgeting and approval
- Vendor selection and lender procedures
- Capitalisation and depreciation
- Fixed assets register
- Physical controls
- Disposal

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

Study text reference: Pages 148, 149 and 182

(a)

- There should be a capex budget prepared based on the requirements submitted by the heads of department.
- Prior to purchasing a fixed asset, the respective head of department must fill a capital expenditure requisition form and forward it to the chief accountant. The chief accountant should then check whether the requested purchase has been approved in the capex budget and if so, certify the requisition and forward the certified requisition to the purchasing officer.
- The purchasing officer should obtain at least three quotations from reputed suppliers and forward them to the chief accountant. The chief accountant should check the quotations against the approved capex budget and in consultation with the respective head of department, recommend the purchase from the most suitable supplier, considering the price and quality of the quoted items.
- The chief accountant should forward the requisition and quotations along with the recommendation to the managing director for approval and evaluation.
- If there is a cost overrun (actual expenditure exceeding the estimated cost reflected in the budget) at the time of purchase of any asset, the additional expenditure should be submitted for board approval. The managing director must approve the capital expenditure with covering approval from the board of directors, if the expense to be incurred is urgent.
- Respective head of department should inspect the fixed asset once supplied for the quantity, quality and functionality as stated in the purchase requisition.
- Purchasing officer should check the details in the supplier invoice for the PPE against the purchase requisition and the physical goods, and authorise the invoice for payment.

(b)

- The business only accepts cash, which means there is a significant amount of cash collected daily. Also, since a cashier and other employees are employed to manage the cash, there is a risk of theft by them. Cash may be stolen or there is a possibility of misappropriation of it by the cashier/employees.
- There is a risk that receipts may not be issued to all customers. If that is the case, it may be difficult to assess whether cash is available/collected for all the sales made. There is yet again a risk of misappropriation of cash.
- There is a risk of issuing incorrect cash receipts to customers. If daily sales are reconciled with the cash collected, there could be a mismatch.
- Since the shop is open for long hours including on bank holidays, cash could be stolen by burglars if there is no proper control to either bank it or safely keep it in a different location.
- Suraj does not check the cash collected daily with the daily sales. This will leave room for misappropriation of cash.

(Total: 10 marks)

Answer 04

Learning outcome/s: 3.2.1 and 4.2.2

3.2.1 Explain the importance of operating effectiveness of internal control.

4.2.2 Explain integrity, objectivity, professional competence and due care, confidentiality and independence.

Study text reference: Pages 230, 231 and 256

(a) Inherent limitations of the internal control system.

- Purchasing manager placing orders with suppliers who have quoted higher prices by mistake → human error.
- The accountant and the purchasing manager dividing such stolen money amongst themselves → collusion.
- Operations director's instructions to place orders → override of controls
- System issue → software failure
- Delivering wrong flowers to customers → human error

(b)

Accountants have an obligation to their employers and clients to know what they are doing, and to do it right.

The principle of professional competence and due care imposes an obligation on accountants to:

- Maintain their professional knowledge and skills at the level required to ensure that their clients or employers receive a competent professional service.
- Act diligently in accordance with applicable technical and professional standards when providing professional services.

(Total: 10 marks)

Answer 05

Learning outcome/s: 5.1.1

Explain the concept of assurance.

Study text reference: Page 276

(a)

- An assurance engagement will involve a **three-party relationship** (separate parties):
 - Intended user – the person who requires the assurance report
 - Responsible party – the organisation responsible for preparing the subject matter to be reviewed, and
 - Practitioner (i.e. an accountant) – the professional who will review the subject matter and provide the assurance
- A second element is a **suitable subject matter**. The subject matter is the data that the responsible party has prepared and requires verification. It can take many forms including financial performance (e.g. historical financial information), non-financial performance (e.g. key performance indicators), processes (e.g. internal controls) and behaviour (e.g. compliance with laws and regulations).
- **Suitable criteria** is required in an assurance engagement. The subject matter is compared to the criteria in order for it to be assessed and an opinion provided. These criteria will depend on the nature of the subject matter.
- Sufficient **appropriate evidence** has to be obtained by the practitioner in order to give the required level of assurance.
- An **assurance report** is the opinion that is given by the practitioner to the intended user and the responsible party.

(b)

- (i) Reasonable assurance means that the auditor provides a high, but not absolute level of assurance, and has carried out sufficient appropriate work to be able to state that the financial information audited gives a true and fair view, and is free from material misstatements.

Limited assurance means that the auditor provides a limited level of assurance that nothing has come to the attention of the auditor that indicates the financial information subject to review is free of material misstatements. The extent of work carried out is normally less, which means that less reliance can be placed on a limited assurance report.

- (ii) The advantages of obtaining limited assurance report.

- The user of the financial information receives some comfort (sufficient assurance) that the information is plausible, even though that assurance is less than reasonable assurance.
- The report adds some credibility to the financial information because it has been reviewed by a professional accountant.
- The report will be more cost-effective than obtaining a full reasonable assurance report.

(Total: 10 marks)

Answer 06

Learning outcome/s: 5.5.3 and 5.5.4

5.5.3 List different audit procedures used to gather audit evidence.

5.5.4 Explain how an auditor considers the relevance and reliability of information to be used as audit evidence.

Study text reference: Pages 303, 304, 310 and 311

(a) Testing procedures

- Inspection
- Observation
- Inquiry and confirmation
- Re-calculation
- Re-performance
- Analytical procedures

(b)

- Relevance deals with logical connection of the purpose of the audit procedure and the assertion under consideration.
- Mohan should keep in mind what assertions to address when auditing accounts receivable. These include RO, existence, valuation etc. Therefore, he should obtain audit evidence to address the relevant assertions. For instance, when perusing the contract with a debtor, the invoices issued to the debtor will provide evidence on existence, the right the entity has to recover the amount owed by the debtor.
- Reliability is influenced by the source and nature of the information, including the controls over its preparation and maintenance.
- External sources, for example, are likely to be more reliable than internal sources. As such, when verifying the existence of trade receivables, Mohan may request confirmations from selected debtors at the balance sheet date. Similarly, he needs to ensure the audit evidence he obtains is also reliable and not forged. Professional skepticism is important in ensuring the reliability of audit evidence.

(Total: 10 marks)

SECTION 3

Answer 07

Learning outcome/s: 2.1.3, 2.2.2, 2.5.1 and 2.6.3

- 2.1.3 Assess the business risk connected with sub-activities relating to the procurement process.
- 2.2.2 Identify the documents relating to the payroll process, point of origination, flow of documents and purpose.
- 2.5.1 Identify activities connected with the inventory management process, such as deciding optimum order quantities, physical safeguard of inventory, receiving/issuing goods etc.
- 2.6.3 Business risk in the sales process.

Study text reference: Pages 99, 117 – 123 and 195

Pages 10 and 11 (additional study support material)

(a)

- The risk of invoicing/ordering at an excessive price (as there is a fixed price) – the entity has agreed the price with the supplier. In case the entity fails to renew the contract, there is a risk that it can be charged a higher price, which will increase the cost of purchases.
- If the order is placed with an alternative supplier there may be a risk that this supplier is unable to supply materials as and when required.
- The quality of the product is critical for buyers. The raw material quality has an impact on the final product. The supplier who supplies the material has faced quality issues and there is a risk that Sigma will not be able to get good quality materials.
- The raw materials have been written-off. This indicates the purchases may have been made without giving due consideration to the production plan and without assessing the requirements for purchases. Therefore, there is a high risk of purchasing excessive materials or materials that are not required.

(b)

- (i) Unclaimed wages report: to have control over the wages that were not collected by the workers and ensure they are subsequently handed over to the right worker.
- (ii) Overtime list: to ensure overtime is paid for those employees who were requested to work with the approval of the line manager.
- (iii) Monthly payroll report: to ensure salaries/wages are formally approved and paid only to those who have been employed by the entity.
- (iv) Payroll reconciliation: to verify that employees have been properly paid, payroll expenses are applied to the appropriate accounts in the general ledger, and tax is paid to the Inland Revenue Department and reported accurately.

(c) (i)

- Each production unit is different, prices are different, and the consumption of materials is slightly different. When there is no proper record of transfers the actual consumption and costs involved in each line of production cannot be accurately assessed.
- When returned goods are not recorded appropriately, there is a risk of misplacement/theft of such assets or of them being wasted. There will also be an opportunity for fraud.

(ii) Transfers – material transfer note
Returns – material returned notes

(d)

- Sales orders should be evaluated by an authorised person in terms of quantity, product code, delivery date, availability of raw materials and other resources. They should be signed and confirmed by the sales manager and sent to the customer services department for order processing.
- There could be errors in entering sales order details to the system. There must be a process to check and confirm the accuracy of the data entered into the system, as this data is critical for delivering the right goods, at the right time to the customers.
- A person should be responsible for timely monitoring of the status of sales orders to ensure inventory and the quantity ordered are available for timely shipment of products. This person must also approve the sales orders for packing and shipment.
- In order to avoid any mistakes in packing and shipment, it is necessary to go through the descriptions of required goods mentioned in the sales orders with the packing list of the shipment. This will ensure the goods packed match the sales orders.

(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).
