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

# **SUGGESTED SOLUTIONS**

## **06204 - Audit and Assurance**

Certificate in Accounting and Business II Examination  
March 2014

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

## Answer No. 01

- (a)
- (i) Objectivity
  - (ii) Independence
  - (iii) Professional judgment
- (b)
- (i) Requirement of any legislation or regulation under which the engagement is conducted
  - (ii) The terms and conditions of the engagement
  - (iii) Ethical and professional standards
  - (iv) Quality control standards
  - (v) Internal regulations and internal control procedures
- (c) By issuing an engagement letter that precisely states the terms and conditions of the engagement and responsibilities of each party, including the objective of the engagement, responsibilities of each party involved in the engagement and the scope of the engagement with reference to relevant criteria  
By expanding the conclusion clearly indicating in the audit report the scope of the engagement, objectives of the engagement, audit methodology and the sample, and responsibilities of the practitioner and the responsible party (management).
- (d) In a report of a limited assurance engagement a negative form of expression of conclusion is given whereas in a report of a reasonable assurance engagement a positive form of expression of conclusion is given.
- (e)
- i. Read the financial statements of Sumihiri PLC for the year ended 31 December 2012 and the auditor's report thereon for information relating to opening balances
  - ii. Determine whether the prior period's closing balances have been correctly brought forward as current year's opening balances
  - iii. Determine whether the opening balances reflect the application of appropriate accounting policies
  - iv. Follow appropriate ethical requirements to communicate with prior year auditors and if possible review prior year working papers to obtain evidence regarding opening balances
  - v. Evaluate whether audit procedures performed in the current year provide evidence relevant to the opening balances
  - vi. Performing specific audit procedures to obtain evidence relating to the opening balances
- (f)
- i. Purchases not matched with demand for products
  - ii. Quality checks are carried out by the Factory Manager, thereby he is the only individual with authority to accept or reject a supply
  - iii. No segregation of duties between receiving goods and recording of the same in purchase register. Therefore, there is a possibility of the Manager entering fictitious entries for his personal gain
  - iv. Cheques are issued based on entries in the purchase register rather than on invoices provided by the supplier
  - v. Person who receives goods is also the authorized signatory for payments

## Answer No. 02

- (a) An auditor needs to consider if significant matters have arisen within the context of services provided and the implications on the continuation of the relationship with the client.
- (b)
- Reporting objectives of the engagement to plan the timing of the audit and the nature of the communication required
  - Characteristics of the engagement that define its scope
  - Factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts.
  - Results of preliminary engagement activities and knowledge gained on other engagements performed by the engagement partner for the entity, and,
  - The nature, timing and extent of resources necessary to perform the engagement
- (c)
- (i) - The Accounting department does not have a process in place to identify significant changes in accounting standards and address accounting issues that arise from them.
- Communication channels within the company are not strong enough to keep the Finance department informed of changes that operations make which affect financial statements.
  - There is no mechanism to identify risks that may arise from transactions, such as the minimum rate guarantee. Relevant approval processes for such matters are not present.
- (ii) When the auditor disagrees with management on the application of accounting standards, and if the disagreement is material to the financial statements, the auditor should express a qualified audit opinion.
- (d)
- Transactions which are very few in number but are of very great importance – e.g. transactions involving land - Important items in the financial statements due to their nature or legal requirement – Tax/directors emoluments
  - Extraordinary items
  - High risk areas
  - Instances where the auditor is forced to inquire into in detail as the circumstances are suspicious

**Answer No. 03**

(a) The following are circumstances where professional accountants are/maybe required to disclose confidential information or when such disclosure may be appropriate:

- (1) Disclosure is permitted by law and is authorized by the client or the employer
- (2) Disclosure is required by law, for example:
  - i. Production of documents or other provision of evidence in the course of legal proceedings;
  - ii. Disclosure to appropriate public authorities of infringements of the law that come to light
- (3) There is a professional duty or right to disclose, when not prohibited by law:
  - i. To comply with the quality review of a member body or professional body;
  - ii. To respond to an inquiry or investigation by a member body or regulatory body;
  - iii. To protect the professional interests of a professional accountant in legal proceedings; or
  - iv. To comply with technical standards and ethics requirements

(b) The firm could generally provide such services as reviewing the professional qualifications of a number of applicants and providing advice on their suitability for the post. In addition the firm could generally produce a short-list of candidates for interviews, provided it has been drawn up using criteria specified by the assurance client.

The significance of the threat created should be evaluated and if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. In all cases, the firm should not make management decisions and the decision as to whom to hire should be left to the client

**Answer No. 04**

(a)

(i) Permanent Audit file

- Information concerning the legal status and organizational structure of the entity
- Extracts or copies of important legal documents
- Information concerning the industry, economic environment and legislative environment within which the entity operates
- Copies of Articles of Association, certificate of incorporation, BOI agreements etc.
- A complete list of books, and records maintained by the entity
- Statutory requirements to be complied with by the client
- The names, addresses, specimen signatures, rights and duties of responsible officers
- Geographical distribution of client organisation

(ii) Current Audit file

- Overall audit plan and detailed audit programmes
- Analysis of transactions and balances
- Analysis of significant ratios and trends
- Record of the nature, timing, and extent of audit procedures performed and the results of such procedures
- Copies of supporting documents for the amounts verified by the auditor
- Evidence that the work performed by assistants was supervised and reviewed
- Copies of communications with other auditors; experts, and other parties
- Copies of letters or notes concerning audit matters, communication to/discussed with the entity
- The trial balance and a copy of draft financial statements for the period
- Confirmation received from debtors, creditors and banks for the year
- Basis of conclusions and the opinion.

(b)

- i. False
- ii. True
- iii. True
- iv. False

(c)

- i. Auditor's assessment of the risk of material misstatements
- ii. Use of other substantive procedures directed at the same assertion
- iii. Tolerable misstatement
- iv. Auditor's desired level of assurance that the tolerable misstatement is not exceeded by actual misstatement in the population
- v. Amount of misstatements the auditor expects to find in the population

- (d)
  - i. The relevance and reasonableness of the expert's findings or conclusions and their consistency with other audit evidence
  - ii. Relevance and reasonableness of the assumptions and methods used in the circumstances
  - iii. Relevance, completeness and accuracy of the source data used
  
- (e)
  - i. Validity of the addresses of the confirmation requests
  - ii. Return information to state the response to be sent directly to the auditor
  - iii. Assertions being addressed
  - iv. Specific identified risks of material misstatement, including fraud risk
  - v. The layout and presentation of the confirmation request
  - vi. Prior experience on the audit or similar engagements
  - vii. Method of communication (e.g. paper or electronic)
  - viii. Management's authorization or encouragement to the confirming parties to respond to the auditor
  - ix. Ability of the intended confirming party to confirm or provide the requested information

**Answer No. 05**

- (a) i.       -     Review prior year audit work papers  
              -     Review board meeting minutes/shareholder meeting minutes/Register of Directors' interest  
              -     Assess the control environment pertaining to identification, accounting for and disclosure of related parties within the organization  
              -     Review the organizational structure  
              -     Carry out inquiries with regards to affiliations from management  
              -     Review of shareholder records to determine names of principal shareholders  
              -     Review entity's income tax returns and other information supplied to regulatory agencies
- ii       -     Have new commitments, borrowings or guarantees entered into by the company?  
              -     Have any sales or acquisition of assets occurred or have they been planned?  
              -     Have any assets been acquired by the government, or destroyed or disposed of in any manner, e.g. fire or flood?  
              -     Have any unusual accounting entries been proposed?  
              -     Have events occurred that will question the appropriateness of accounting policies and estimates in the current year?  
              -     Are there any litigation and claims?
- iii       The audit team may perform the following audit procedures to identify mitigating factors of going concern:  
              -     Analyse and discuss cash flow, profit and any other relevant forecasts with management  
              -     Analyse the latest available financial information  
              -     Review any subsequent amendments/correspondence with banks/financial institutions  
              -     Read minutes of meeting with shareholders/board and any other relevant committees  
              -     Inquiry from entity's lawyers
- (b)       -     Entity's profit after tax is unusually small  
              -     Entity's profit after tax fluctuates significantly from year to year
- (c)       Conclusions document whether sufficient appropriate audit evidence for each audit objective has been obtained. The conclusions drawn from the audit evidence obtained is the basis for the expression of an opinion on the financial statements.

**Answer No. 06**

- (a)
- i. Inquiries of the management and the others within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error
  - ii. Analytical procedures
  - iii. Observation and inspection
- (b)
- i. Manipulation, falsification (including forgery) or alteration of accounting records or supporting documents from which the financial statements are prepared
  - ii. Misrepresentation in or intentional omission from the financial statements of events, transactions or other significant events
  - iii. Intentional misapplication of accounting principles relating to amounts, classifications, manner of presentation or disclosure
- (c)
- i. Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both
  - ii. Unauthorized access to data that may result in destruction of data or improper changes to data
  - iii. Possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties
  - iv. Unauthorized changes to data in master files
  - v. Unauthorized changes to systems or programs
  - vi. Failure to make necessary changes to systems or programs
  - vii. Inappropriate manual intervention
  - viii. Potential loss of data or inability to access data as required
- (d)
- i. In planning and performing the audit
  - ii. When evaluating the effect of identified misstatements on the audit and of uncorrected misstatements if any on the financial statements
  - iii. In forming the opinion in the auditor's report
- (e)
- i. To reasonably guarantee that data received for processing are genuine, complete, not previously processed and properly authorized
  - ii. To reasonably guarantee that data are entered accurately and without duplication.

**Answer No. 07**

- (a)
- i. Substantive procedures:  
Audit procedures designed to detect material misstatements at the assertion level
  - ii. Test of controls:  
Audit procedures designed to evaluate the operating effectiveness of controls in preventing or detecting and correcting material misstatements at the assertion level
- (b)
- i. The control environment and other relevant controls
  - ii. Availability at a later date of information necessary for the auditor's procedures
  - iii. Purpose of the substantive procedures
  - iv. Assessed risk of material misstatements
  - v. Nature of the class of transaction or account balance and related assertions
  - vi. Ability of the auditor to perform appropriate substantive procedures to cover the remaining period
- (c)
- i. Confirm or inspect title deeds to all properties
  - ii. Perform land search for properties
  - iii. Inspect lease agreement or obtain direct confirmation from bank or other custodian of PPE
  - iv. Inspect the motor vehicle registration documents
- (d)
- i. If revision of the audited financial statements is necessary, follow the procedure as per auditing standard on subsequent events
  - ii. If revision of the other information is necessary and management agrees to make the revision, the auditor should carry out the required procedures
  - iii. If revision of other information is necessary and management refuses to make the revision, auditor should notify those charged with governance and take appropriate action such as obtaining legal advice
- (e)
- i. Evaluate whether the summary financial statements adequately represent their summarized nature and check if they are accompanied with the audited financial statements
  - ii. When summary financial statements are not accompanied by the audited financial statements, evaluate whether they describe clearly from whom or where the audited financial statements are available
  - iii. Evaluate whether the summary financial statements are prepared in accordance with the applied criteria
  - iv. Evaluate whether the summary financial statements adequately disclose the applied criteria
  - v. Compare summary financial statements with the related information in the audited financial statements to determine whether the summary financial statements agree
  - vi. Evaluate whether the audited financial statements are available to the intended users of the summary financial statements without undue difficulty

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