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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
September 2013

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

Answer No. 01

- a)
- i. Practitioner has to agree the procedures with the other parties involved in the engagement in an agreed upon procedure engagement whereas in assurance engagements the practitioner performs procedures based on his assessment
 - ii. In agreed upon procedures practitioner reports on findings based on procedures performed whereas in assurance engagements the practitioner make a conclusion based on findings

(2 marks)

- b)
- i. The reliability of audit evidence is increased when it is obtained from independent source outside the entity.
 - ii. The reliability of audit evidence that is generated internally is increased when the related controls imposed by the entity are effective
 - iii. Audit evidence is obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.
 - iv. Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally.
 - v. Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies.

(4 marks)

- c)
- i. Inherent risk
 - ii. Control risk
 - iii. Detection risk

(3 marks)

- d)
- (i)
 - * Unidentified balances in the bank reconciliations.
 - * The debtors schedule does not agree to the ledger and it has not been reconciled.
 - * The debtor confirmations do not agree to the ledger balance
 - * Pressure on finalizing the audit within a shorter period than last year.

(3 marks)

- (ii)
 - Evaluation of external confirmations from the debtors.
 - Agree opening balances to the last year's accounts.
 - Carry out analytical procedures such as
 - comparison of the current figures with those of prior periods.
 - review and comparison of key ratios or other performance indicators.
 - review of large and/ or unusual items and verify.
 - review postings to ledger and adjustments

(3 marks)

- e)
- i. Integrity of the principal owners, key management and those charged with governance of the entity.
 - ii. Whether the engagement team is competent enough to perform the audit engagement and has the necessary capabilities, including time and resources
 - iii. Whether the firm and the engagement team can comply with relevant ethical requirements
 - iv. Significant matters that have arisen during current or previous audit engagement and their implications for continuing the relationship

(3 marks)

- f)
- Financial statements show true and fair view.
 - Financial statements have been prepared based on Sri Lanka Accounting Standards

(2 marks)
(Total 20 marks)

Answer No. 02

- (a)
- i. Reliability of financial reporting
 - ii. Effectiveness and efficiency of operations
 - iii. Compliance with applicable laws and regulations

(3 marks)

- (b)
- (i)
- i. No segregation of duties as petty cash payment and cash receipts are handled by the same party
 - ii. When internal cheques are cashed using money received, the receipts cannot be reconciled with cash banked, thereby increasing possibilities for misappropriation
 - iii. No authorisation for expenditure incurred by sales staff (increasing possibilities for misappropriation)
 - iv. Not banking cash receipts intact
 - v. Not reimbursing petty cash when a minimum balance is reached and thereby using receipt for petty cash expenditure

Any other suitable answer

(4 marks)

- (ii)
- i. Receipts and payments to be handled by two staff members
 - ii. Instruct the receipts cashier to bank the cash received intact
 - iii. Not allowing the other staff members to exchange either cheques issued by the company or their personal cheques to be cashed internally
 - iv. Not allowing the settlement of advance until expenditure incurred is authorised by a manager in-charge

Any other suitable answer

(4 marks)

- (c)
- i. Any indication that the entity misunderstands the objective and scope of the audit
 - ii. Any revised or special terms of the audit engagement
 - iii. A recent change of the senior management
 - iv. A significant change in ownership
 - v. A significant change in nature or size of the entity's business
 - vi. A change in legal and regulatory requirements
 - vii. A change in financial reporting framework adopted in the preparation of the financial statements
 - viii. A change in other reporting requirements

(4 marks)

- (d)
- i. Determine the resources to deploy for specific audit areas such as the use of appropriately experience team members for high risk areas or the involvement of experts on complex matters
 - ii. Determine the amount of resources to allocate to specific audit areas such as number of team members assigned to observe inventory count
 - iii. Determine when those resources are required to be deployed
 - iv. Determine how such resources are managed, directed and supervised

(3 marks)

- (e)
- i. Emphasising to the audit team the need to maintain professional scepticism
 - ii. Assigning more experienced staff or those with special skills or using experts.
 - iii. Providing more supervision
 - iv. Incorporating additional elements of unpredictability in the selection of further audit procedures to be performed
 - v. Making general changes to the nature, timing and extent of audit procedures

(3 marks)

- (f)
- i. The elements of financial statements (e.g. assets, liabilities, equity, revenue, expenses)
 - ii. Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused (e.g. profit / revenue / net assets)
 - iii. The nature of the entity, where the entity is in its life cycle, and the industry and the economic environment in which the entity operates
 - iv. The entity's ownership structure and the way it is financed.
 - v. The relative volatility of the benchmark.

(4 marks)

(Total 25 marks)

Answer No. 03

- (a) There will be a threat to independence (independence in mind as well as independence in appearance), specifically as there is a self review threat, when Jack has to review his own work

(3 marks)

- (b) There will be a threat to independence (independence in mind as well as independence in appearance), specifically as there is an advocacy threat when Jill appears on behalf of the company

(3 marks)

- (c) There will be a threat to independence (independence in mind as well as independence in appearance), if the job is accepted as there will be a familiarity threat. Before accepting the job there can be a self interest threat if the Manager is willing to accept the job, since he would want to please the management to secure his job.

(4 marks)

(Total 10 marks)

Answer No. 04

- (a)
- i. The size and complexity of the entity.
 - ii. The nature of the audit procedures to be performed.
 - iii. The identified risks of material misstatement.
 - iv. The significance of the audit evidence obtained.
 - v. The nature and extent of exceptions identified.
 - vi. The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
 - vii. The audit methodology and tools used.

(3 marks)

- (b)
- i. Inspection
 - ii. Observation
 - iii. External confirmation
 - iv. Recalculation
 - v. Reperformance
 - vi. Analytical procedures
 - vii. Inquiry
- (4 marks)**
- (c)
- i. Completeness- Evaluate the system of internal controls. If satisfactory select a sample to check recording, posting and arithmetical accuracy of the selected accounts
 - ii. Existence - Check whether goods and services have been received from supplier
 - iii. Existence - Call for confirmation of balances
 - iv. Existence - Check with subsequent payments with following year's cash book
 - v. Completeness- Comparison of supplier statements with purchase ledger accounts
 - vi. Valuation - Check the supplier's invoices.
 - vii. Valuation – Ensure that the treatment complies with the requirements of relevant accounting standards.
 - viii. Completeness – List all debit balances over a Rs. amount and obtain explanation.
 - ix. Existence – Obtain or prepare a list of trade payable. Agree the list to the control accounts obtain explanation for all material adjustments to the control accounts.
Any other valid procedure.
- (4 marks)**
- (d) Sampling risk – The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure
- (2 marks)**
- (e)
- i. The emphasis on relevant controls in the auditor's risk assessment.
 - ii. The tolerable rate of deviation.
 - iii. The expected rate of deviation of the population to be tested.
 - iv. The auditor's desired level of assurance that the tolerable rate of deviation is not exceeded by the actual rate of deviation in the population.
 - vi. The number of sampling units in the population.
- (2 marks)**
- (f) AB Associates
- (1 mark)**
- (Total 15 marks)**

Answer No. 05

- (a)
- i. Monitoring of internal control.
 - ii. Examination of financial and operating information.
 - iii. Review of operating activities.
 - iv. Review of compliance with laws and regulations.
 - v. Risk management.
 - vi. Governance.
- (3 marks)**

(b)

Objectivity

- i. The status of the internal audit function within the entity and the effect such status has on the ability of the internal auditors to be objective.
- ii. Whether the internal audit function reports to those charged with governance or an officer with appropriate authority, and whether the internal auditors have direct access to those charged with governance.
- iii. Whether the internal auditors are free of any conflicting responsibilities.
- iv. Whether those charged with governance oversee employment decisions related to the internal audit function.
- v. Whether there are any constraints or restrictions placed on the internal audit function by management or those charged with governance.
- vi. Whether, and to what extent, management acts on the recommendations of the internal audit function, and how such action is evidenced.

Technical competence

- vii. Whether the internal auditors are members of relevant professional bodies.
- viii. Whether the internal auditors have adequate technical training and proficiency as internal auditors.
- ix. Whether there are established policies for hiring and training internal auditors.

Due professional care

- x. Whether activities of the internal audit function are properly planned, supervised, reviewed and documented.
- xi. The existence and adequacy of audit manuals or other similar documents, work programs and internal audit documentation.

Communication

- xii. Internal auditors are free to communicate openly with the external auditors, and meetings are held at appropriate intervals throughout the period

(3 marks)

(c)

- i. Positive confirmation request – A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information.
- ii. Negative confirmation request – A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.

(2 marks)

(2 marks)

(d)

- i. The nature and significance of the matter, including its complexity.
- ii. The risks of material misstatement in the matter.
- iii. The expected nature of procedures to respond to identified risks, including the auditors knowledge of and experience with the work of experts in relating to such matters and the availability of alternative sources of audit evidence.

(2 marks)

(e)

- i. Use of an automated billing system to record sales transactions
- ii. Each transaction needs to be serially numbered
- iii. Discourage using manual billing / non billing for sales
- iv. All money received on daily sales needs to be banked. (a separate float kept for change money)
- v. Rotation of staff for each outlet and for cash collection
- vi. Cash collections to be tallied with daily sales records at the time of collecting cash by cash collector and make a record
- vii. Cash received after collections to be stored in a secure place
- viii. Periodic stock counts/cash counts

(3 marks)

(Total 15 marks)

Answer No. 06

(a)

- i. Discuss the matter with management;
- ii. Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and
- iii. Take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SLAuS 705, having regard to the requirement in paragraph 20 of SLAuS 580.

(3 marks)

(b)

- (i)
- Bank and legal confirmations obtained as part of the auditor's procedures
 - Minutes of meetings of shareholders and of those charged with governance
 - Third-party confirmations obtained by the auditor (in addition to bank and legal confirmations).
 - Entity income tax returns.
 - Information supplied by the entity to regulatory authorities.
 - Shareholder registers to identify the entity's principal shareholders.
 - Statements of conflicts of interest from management and those charged with governance.
 - Records of the entity's investments and those of its pension plans.
 - Contracts and agreements with key management or those charged with governance.
 - Significant contracts and agreements not in the entity's ordinary course of business.
 - Specific invoices and correspondence from the entity's professional advisors.
 - Internal auditors' reports.
 - Documents associated with the entity's filings with a securities regulator (for example, prospectuses).

(3 marks)

- (ii)
1. Confirming or discussing specific aspects of the transactions with intermediaries such as banks, law firms, guarantors, or agents, where practicable and not prohibited by law, regulation or ethical rules
 2. Confirming the purposes, specific terms or amounts of the transactions with the related parties
 3. Where applicable, reading the financial statements or other relevant financial information, if available, of the related parties for evidence of the accounting of the transactions in the related parties' accounting records

(3 marks)

(c)

- i. Analysing and discussing cash flow, profit and other relevant forecasts with management.
- ii. Analysing and discussing the entity's latest available interim financial statements.
- iii. Reading the terms of debentures and loan agreements and determining whether any have been breached.
- iv. Reading minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties.
- v. Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications.
- vi. Evaluating the entity's plans to deal with unfilled customer orders.
- vii. Obtaining and reviewing reports of regulatory actions.
- viii. Confirming the existence, terms, adequacy of borrowing facilities.

(3 marks)

(d) Negative Assurance / Limited Assurance / Moderate level assurance (1 mark)

(e) An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of evidence.

(2 marks)
(Total 15 marks)

Answer No. 07

- (a)
- i. The degree of uncertainty about events or conditions being assessed.
 - ii. The information available at the time of judgements are made
 - iii. The size and complexity of the entity, nature and condition of the business and the degree to which it is affected by external factors.

(2 marks)

(b) Whether auditor needs to modify the opinion depends on the disclosures made in the financial statements by the management. If sufficient information about the company not having ability to function as a going concern is available in the financial statements, the auditor can include only an emphasis of matter paragraph in the audit report. However, if appropriate disclosures are not given the auditor needs to modify the opinion.

(6 marks)

- (c)
- i. Discussion of significant matters with the engagement partner
 - ii. Review of the financial statements and the proposed auditor's report
 - iii. Review of selected audit documentation relating to the significant judgments the engagement team made and the conclusions it reached
 - iv. Evaluation of the conclusions reached in formulating the auditor's report and consideration of whether the proposed auditor's report is appropriate

(3 marks)

- (d)
- 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, including the recording of unauthorized or non-existent transactions, or inaccurate recording of transactions.
 - iv. The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
 - v. Unauthorized changes to data in master files.
 - vi. Unauthorized changes to systems or programs.
 - vii. Failure to make necessary changes to systems or programs.
 - viii. Inappropriate manual intervention.
 - ix. Potential loss of data or inability to access data as required.

(4 marks)
(Total 15 marks)

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