THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

SUGGESTED SOLUTIONS

KC4 – Corporate Governance, Assurance & Ethics

June 2016

Answer 01

Relevant Learning Outcome/s:
1.3.1. Evaluate an audit committee charter including the key aspects of an audit committee, such as: - Role of "the audit committee" - Membership and meetings - Financial and management information reporting - Internal controls - Internal audits and external audits - Conflict of interest 1.5.1 Advise on the process of ethical conflict resolution 1.10.1. Advise on the ethical issues and safeguards applicable to provision of non-assurance services. 1.6.1. Advise on the use of conceptual framework approach to complying with fundamental ethical principles, in terms of identifying threats, evaluating the significance of threats and applying safeguards. 1.7.1. Advise on ethical issues faced by a professional accountant in an enterprise for a given scenario.

Suggested Detail Answer:

(a) ***Finance director's statement on the audit committee's responsibilities ensuring compliance with the new rules issued by SEC on related party transactions including the review:-***

The main responsibilities of an audit committee generally include the following:

- Review of financial statements and systems
- Review of internal control
- Review of risk management
- Liaison with external auditors
- Ensure compliance with the legal and regularity requirements.

In reviewing the financial statements, the audit committee ensures whether the financial statements are in compliance with the accounting framework applied (Sri Lanka Accounting Standards). The audit committee also checks the interim/ quarterly reporting to SEC.

The objective of the new rules on "related party transactions" is to ensure that the interests of shareholders are protected. All listed companies should comply with these rules with effect from 1 January 2016. Since HC is a PLC, it also has to comply and the audit committee may direct the board of directors to ensure compliance. <u>However, these rules specify the forming of a "Review Committee" to review related</u>

party transactions. This committee should comprise a combination of non-executive directors and independent non-executive directors. The composition of the committee may also include executive directors, at the option of the listed entity.

The Appendix 9A of the rules states other than the transactions that have been exempted by the rules the review committee should review all related party transactions in advance. Therefore the responsibility for reviewing lies mainly with the review committee and where necessary the review committee should ensure that required approvals of the board of directors is obtained for such transactions.

When making an announcement to the SEC about those related party transactions which exceed the threshold given in the rules, the review committee should make a statement confirming that these related party transactions are on normal commercial terms and there is no prejudice. The annual report should also contain a report of the review committee on related party transactions.

Therefore, the responsibility for transaction review and compliance with the rules introduced by SEC are with the Review Committee. However, when the audit committee reviews the annual financial statements it can also check whether the relevant disclosure specified in the rules are included in the annual report of HC (those transactions that exceed the specified threshold to be disclosed in the annual report)

(b) Process should be in place on related party transactions (RPTs)
The directors are responsible to ensure related party disclosure and reporting on such transactions as per SEC guidance/regulations. To be in compliance with these requirements the directors can design and implement the process to include the following:

- The directors need to define what are the related party (with reference to the definition provided in LKAS 24)
- The process should be in place to identify who the related parties are (can identify the existing subsidiaries, associates and other affiliates)
- A mechanism to capture related party transactions should be in place. For this directors could consider the following:
    - Disclosures by the directors at board meetings regarding their interests in conflicts due to the related party transactions of HC
    - Annual declaration by Key Management Personnel (KMP) regarding their interests in conflicts and whether they have any new related parties
- Compliance with interest register – this need to be updated on a timely basis and directors should ensure all related parties are entered in this register. (Companies Act S 192)

(c) (i) CA Sri Lanka has issued a Code of Ethics for Professional Accountants. This provides five fundamental principles of professional ethics and provides a conceptual framework for applying those principles. CA members must apply this conceptual framework to identify threats to compliance with the principles, evaluate their significance and apply appropriate safeguards to eliminate or reduce so that compliance is not compromised. Therefore the auditors of HC also needs to apply the framework in identifying the threats arising by accepting the accounting services.

The auditors need to perform work objectively and they should be independent from the HC (the auditee). If the external auditor is to accept the proposed work, it involves providing services on accounting, which may involve recommending journals, preparation of financial statements etc. When the auditor is performing the audit, he will be reviewing the revenue figure that the auditor has advised (auditing own work). Therefore, there is a threat of self-review.

Since HC is a listed entity the threat to the auditor will be significant. It is important to ensure that in providing a non-audit service, external auditors do not:

- audit their own work
- make management decisions for the company
- create a mutuality of interest, or
- find themselves in the role of advocate for the company.

Therefore, the external auditor of HC must analyse the risks arising and put safeguards in place to ensure that the risk is at an acceptable level. Safeguards include:

- Using staff members other than assurance team members to carry out work
- Obtaining client approval for work undertaken

Firms should not prepare accounts or financial statements for listed or public interest clients, unless an emergency arises. For any client, assurance firms are also not allowed to:

- Determine or change journal entries without client approval
- Authorise or approve transactions
- Prepare source documents

Therefore, HC can discuss the scope of the work with HC and may only be an advisor in this regard whilst the management of HC accepts the responsibility of the final implementation of the new accounting standard and preparation of financial statements.

(d) Rukmal is a chartered accountant and he has to fulfill the professional obligations to his employer. On the other hand he has to adhere to the code of ethics of the company. Ethical guidance stresses that a professional accountant should normally support the **legitimate and ethical obligations** established by the employer. However in this incident, Rukmal is pressurized to act in a way that threatens compliance with the fundamental principles because the managing director has asked him to arrange for a bribe which is not acceptable as per the business conduct. Now he is in a dilemma. Rukmal needs to maintain integrity in his dealings with the company and he should not be a part of unethical dealings.

Rukmal should act professionally to resolve this conflict. First he may have to approach the managing director and clear his doubts about the payments by requesting necessary approvals and the documentation.

If he refuses to provide those and threaten him, Rukmal needs to make him aware of the company's code of ethics and the prohibition on giving bribes. In this context, he should refrain from acting as per managing director's instructions.

If the managing director does not accept Rukmal's position he needs to inform that he has to take further action. Rukmal could approach his immediate superior, (may be the CFO / finance director) and pressure the managing director to refrain from giving the bribe.

The last resort is to lodge a formal complaint regarding the transaction with the facts to the board of directors**.**

(Total 25 marks)

Answer 02

Relevant Learning Outcome/s:	
2.1.3	Demonstrate the key concepts in enterprise risk management including risk appetite, risk analysis, risk mitigation and risk monitoring.
2.2.2	Propose measures to be taken to embed risk in the organisational culture.
2.3.1.	Evaluate the use of a risk management framework
2.6.1.	Explain the objectives and role of a modern internal auditor.
2.6.2.	Explain the role of internal auditor in enterprise risk management.

Suggested Detail Answer:

(a) Although the directors have identified the need for a rigorous risk management process the divisional managers are of the view that it is not relevant at this point of time. It cannot be established in an adhoc manner in response to a crisis situation.

It cannot be established within a short period of time as it is a complex process that is affected by the board of directors, management and other personnel involved in developing strategy. Establishing a risk management process also involves identifying enterprise-wide potential events that may affect the entity and manage risks to provide reasonable assurance regarding the achievement of an entity's objective.

The divisional manager's view cannot be accepted as the company is facing a crisis situation.

- Every company should have a risk managerial process based on event identification (risk areas and opportunities identified by the senior management with the risk appetite).

- As the company is facing a crisis situation there is a need to introduce or to enhance the risk management process in order to face threats and vulnerabilities

Risk management has the following characteristics:

- It is a process, a means to an end, which should ideally be intertwined with existing operations and exist for fundamental business reasons. Therefore it applies to all the processes in the entity.
- It is operated by **people at every level** of the organization and is not just paperwork. It provides a mechanism for helping people to understand risk, their responsibilities and levels of authority. Therefore it cannot be restricted to a separate department / division.
- It is applied **across the enterprise.** This means it takes into account activities at all levels of the organisation from enterprise-level activities such as strategic planning and resource allocation, to business unit activities and business processes. It includes taking an entity level portfolio view of risk.

- Each unit manager assesses the risk for his unit. Senior management ultimately considers these unit risks and also **interrelated risks.** Senior management will assess whether the overall risk portfolio is consistent with the organisation's risk appetite. Therefore all departmental heads of Smoke have a vital role in risk management.

The managers and divisional heads should have an awareness of the risks that fall into their **areas of responsibility** and possible links with **other areas.** The **performance indicators** they use should help them monitor key business and financial activities and highlight when intervention is required. Line managers will be involved in communicating risk management policies to staff and will of course 'set a good example'. Line managers are also responsible for **preparing reports** that will be considered by the board and senior managers. Therefore in large organizations although a separate risk management division is established to support the management, risk management applies to all in the organization and the divisional managers have a key role to play**.**

(b) **Modern role of the Internal Audit Division of Smoke**

The internal auditor's role in Smoke PLC is limited to the control over accounting and financial reporting. However, the modern internal auditor's role cannot be restricted only to financial accounting & reporting. The role of the internal auditor has expanded in recent years as internal auditors seek to monitor all aspects (not just accounting) of organisations, and add value to their employers. The management of Smoke needs to understand and can widen the scope of internal auditors, as the management is more concerned about risks, the internal auditor can have a role to play in risk management. Therefore their scope can be extended to risk management activities.

- **Review of the economy, efficiency and effectiveness** of operations.
- **Review of compliance** with laws, regulations and other external requirements, with internal policies and directives, and with other requirements including appropriate authorization of transactions.
- **Review of the safeguarding of assets**. Are valuable, portable items such as computers or cash secured, is authorisation needed for dealing in investments.

- **Review of the implementation of corporate objectives**. This includes review of the effectiveness of planning, the relevance of standards and policies, the organisation's corporate governance procedures and the operation of specific procedures such as communication of information.
- **Identification of significant business** and financial **risks.**
- **Monitoring** the **organisation's overall risk management policy** to ensure it operates effectively,
- **Monitoring** the **risk management strategies** to ensure they continue to operate effectively
- **Special investigations** into particular areas, for example suspected fraud.
- Monitoring of day to day transactions to ensure the control procedure is followed.

(c) **MEMO**

To : Board of directors

From : Internal audit division

Date : **xxxx**

Subject: Risks and responses

The table below provides possible responses for the identified risks which have been updated in the risk grid. First we need to immediately address these risks which are almost certain and they are discussed below.

	Risks	**Responses**
1.	Increase in illicit supply of tobacco products	This issue will have a major impact. Therefore we need to respond as follows: • Get into a conversation with the government authorities and police to find out the suppliers who do supply illicit tobacco products • The company can employ persons who will be able to find such suppliers and reward them accordingly
2.	Increase in government levies on tobacco products	• Engage in an effective dialog with the government authorities. Demonstrate with facts and figures the existing payments to the government in the form of levies, taxes. • Discuss about the business risks and impact to the economy by analyzing the people who depend on the company (e.g. tobacco leaf famers)
3.	Increase in awareness of health and safety issues in the country	• Increase the sponsorship for health programs • Seek for alternative products which are not harmful for the health (organic products which meet the same use, virtual smoking methods)
4.	Enforcement by government officials in an unfair manner	This will have a severe impact. Some action is required: • Building up a good relationship with government authorities

	Risks	Responses
		• Demonstrate the support of the company for government initiatives
5.	Increase of graphical health warning in the package up to 100%	This will have a major impact: • Have an effective dialog with the government authorities. Demonstrate that this product is already having the graphical warning and communicate the fact that demand will not vary significantly. (All people do not buy packets)
6.	Reputation risk	The adverse publicities should be avoided: • Engage in corporate social responsibility initiatives • Disclose in the annual report the contribution made to the society.
7.	Discontinuation of leaf supply to the company as the farmers have difficulties in cultivation due to weather changes or encouragement by government to shift to other cultivations	• Seek for alternative methods of getting tobacco • Provide assistance to the farmers • Discuss with the government to convince that there is an economic benefit to the country and they will lose the tax revenue and this will provide employment opportunities. Obtain an insurance policy.
8.	Imposing of liability for product sold	• Obtain an insurance policy. • Legal advice to be obtained
9.	Usage of substitute products. Changes in consumer patterns	Product differentiation to cater to low income groups. Establish a unit to research for innovative products.
10.	Govt. rules and regulations.	Appoint a committee to monitor compliance.
11.	Another manufacturer of tobacco products would enter into the market.	• Build up the image of the company. • Produce innovative products.
12.	Failure in distribution channels	• Have a strong relationship with the distributors. • Implement a scheme to reward them.
13.	Default in settlement of loans to out growers	• Obtain a security for loans. • Introduce CSR projects to enhance the income.

(Total 25 marks)

Answer 03

Relevant Learning Outcome/s:
3.1.1 Develop an overall audit strategy for an audit engagement, including an audit of the financial statements of a group and an SME. 3.2.1. Evaluate financial information and non-financial information relating to economic, industry and business matters to identify risk of material misstatements, including the financial statements of a group and SME 3.3.1 Propose further audit procedures to address identified risk of material misstatement. 4.1.2. Advise on the need to change the audit approach for a given scenario. 4.2.1. Evaluate the effect of identified misstatements on the audit and the effect of uncorrected misstatements, if any, on financial statements. 5.2.2. Evaluate the system of quality control of a firm and recommend improvements under SLQC1 5.3.1. Propose areas that are important in undertaking an engagement quality control review for a given engagement.

Suggested Detail Answer:

(a) **Business risk** is the risk inherent to the company in its operations. Business risk and audit risk are of a different nature.

- Business risk arises in the operations of a business
- Audit risk is focused on the financial statements of the business
- Audit risk exists only in relation to an opinion given by auditors

However, as stated by the audit partner, Mr. Nihal Gunawardena the business risks and audit risks are strongly **connected**. At the most basic level, almost everything that a company does results in some sort of financial effect, and where there are financial transactions there is always the risk that these transactions are incorrectly reported.

For instance in Ruhuna Putra the following risks could be identified:

Business risks	**Audit risk resulting from the business risk**
Super market: There is a risk of increase in cost per customer and therefore will not be able to achieve sales targets / market share in the industry	The management has a vision and goals for its business. If the management wants to show good results, there is a possibility of misstating either revenue or costs. For instance fictitious sales could be recorded and all expenses may not be recognized in the books of account. Therefore there is a risk of misstatement in revenue and expenses of the supermarket. Risk of fraud needs to be considered by the auditor.
Devaluation of the Sri Lanka Rupee will impact the import cost of LP Gas and the company is compelled to increase the prices by negotiating with the government. There is a risk that the required price increase will be controlled by the regulatory authorities	The profits and margins get affected. This will result in working capital issues. If the situation worsens, the auditor will need to assess the risk of going concern (but very unlikely in this industry).
Ruhunu Putra has an objective of creating a world class conglomerate. This will result in diversification in business operations and it will invest in new entities in new business lines. However, this will not generate the return expected by the management.	• This will result in an impairment of investment and the auditor needs to seek audit evidence in this regard • Further, this will result in related party transactions. Therefore, the risk of fraud may arise on those transactions and the auditor needs to assess the risk of fraud on related party transactions.
Ruhunu Putra Tea Exports is facing downturn and as a result losses have been incurred	The auditor needs to assess the risk of going concern on Ruhunu Putra Tea Exports.
There are related party transactions (e.g. building given on lease). There will be a business risk that the resulting dues from the transactions will not be recovered	Risk of impairment of dues from related parties (specially amounts due to LPE from LPTE).

(b) **Propose** the risks of material misstatements that E&F needs to consider in planning the entity audit of RPE.

In planning the audit, the auditor carries out certain procedures to identify the audit risks or risks of material misstatement in the financial statements. Based on the available information E&F may consider the below areas which will result in material misstatements in the financial statements:

- **Investments**: RPE has many subsidiaries. E.g. Supermarket, Tea Export, Air conditioner, Leisure etc. The auditor needs to consider the “valuation” assertion of these investments because as per the given information some subsidiaries are not performing well. Hence, the auditor needs to see whether those investments have been impaired and if so, how the management has identified such impairment charges (its appropriateness).

- **Risk of fraud in revenue recognition**: In every audit this will become a rebuttable presumption. In RPE the auditor may consider this risk because there is a pressure on reduction of prices from the government due to the reduction in world prices and pass the benefit to the customers. As a result, the revenues of RPE may be reduced and the management may not want to recognise a reduction in revenue. Therefore there is a risk of inflating the revenue of RPE.

- **Risk of management override of controls:** In every audit this risk arises (due to the risk of fraud). There can be instances of management overriding the established procedures or policies in order to manipulate the financial results. For instance, by passing journal entries for provisions where there is no certain obligation. Since the share prices also fluctuates, the management may attempt to disclose healthy financial results in order to boost the investor confidence.

- **Inappropriate accounting treatment:** The Company incurs many expenses for employees on training and development. Further, there is a manufacturing plant that carries out a number of branding activities and R&D activities (the scenario does not specify whether there is a separate company for the manufacturing. Therefore, it is assumed that it operates as a business unit of RPE). There is a risk that the company may capitalize these expenses as intangibles.

- **Risk of fraud:** An incident of fraud has been identified related to the ERP system. If RPE is also using the same system, there is a possibility of manipulating the system. Therefore, there is a high risk of fraud.

- **Investment properties:** The balance sheet of the company reflects investment properties and it seems that the company has adopted the fair value model. The fair valuation is an estimate and there is a risk of deciding inappropriate fair values for investment properties. The income statement reflects the same fair value amount on investment properties as last year. The auditor needs to investigate this.

- **Presentation of financial statements:** This is a PLC and the accounts are published. Those need to be in compliance with Sri Lanka Accounting Standards. As per the given financial statements, the items that need to be presented in OCI have been presented under statement of changes in equity

(SOCE). LKAS 1 states SOCE should only reflect the transactions with the owners (e.g. dividends, share issue etc.,) therefore, there is a risk that the management has not presented the financials appropriately and disclosures are not properly made (as "Segmental information" of the company is not appropriately presented).

- **Accounting for investment properties**: During the year the company has leased out a building at Wattala. This has to be accounted as investment properties (transfer from PPE to investment properties). There is a risk that this transfer has not taken place appropriately. The variance in investment properties from last year to this year approximates to the fair value gain identified. This implies the above transfer has not taken place appropriately.

- Risk arising from related party transactions.

(c) **Advise** E&F on specific considerations E&F should consider when planning the group audit of RPE for the year ended 31 March 2016.

As the auditors of Ruhunu Putra group, E&F is responsible for the group opinion. There are a number of subsidiaries in the group. Except one subsidiary, other subsidiaries are audited by E&F. However, the scenario does not provide the details of the shareholding of the Air Condition company and the plastic manufacturing company. Therefore, it is vital that E&F understands the full group structure in order to identify "significant components".

Albert Silva & Co, is the auditor of RPL (Leisure). As per the given financial information the previous financials were not significant to the group results. Although this year, the result of Leisure reflects only about 2% (revenue is less than 1% of group revenue) of group profit, the group auditor may conclude it is not material to the group. However, the assets of Leisure represents 23% of the total assets of the group. Given the fact that Leisure is just a startup company and the significance of the expansion and assets owned, may suggest that this year E&F should obtain deliverables from the component auditor (i.e. Albert Silva & Co),
If E&F decides that the Leisure company is included in the scope, it has to decide what sort of deliverables E&F expects from Albert Silva & Co. E&F can request the following:

- A full audit using component materiality
- An audit of specified account balances related to identified significant risks
- Specified audit procedures relating to identified significant risks.

If E&F decides the use of a component auditor, it has to consider the independence and competence of the component auditor. Since E&F is the auditor of other components, it is easy for E&F to direct the testing of other entities.

As the group auditor of Ruhunu Putra, E&F is responsible for setting the materiality level for the group financial statements as a whole. Materiality levels should also be set for components which are individually significant. These should be set at a lower level than the materiality level of the group as a whole.

(d) **Evaluate** the impact of the interim audit findings in RPS to the audit strategy of RPS for the audit for the year ended 31 March 2016.

As a result of undertaking initial audit work, auditors may revise their risk assessment and make modifications to their planned approach and procedures. Since the auditors have performed interim work on supermarkets, the interim findings suggest that as the previous year, the auditors will not be able to adopt a control based audit approach. Since the controls have not been implemented effectively, the auditor is not in a position to rely on the controls identified (as give in un-seen scenario).

Since there are deficiencies in the controls, the auditor needs to conduct more extensive substantive testing at the final stage. These involve more audit work in the areas the auditor has identified deficiencies. For instance without relying on the controls over daily reconciliations of sales the auditor needs to design substantive testing to address this deficiency.

Since there had been a fraud and many control deficiencies the auditors can introduce greater unpredictability into the audit procedures. These procedures involve testing low value items, change in the sample selection methods, performing audit procedures on surprise basis etc.

(e) **Evaluate** the effect of present business conditions of RPT to the audit report of RPE for the year ended 31 March 2016.

RPT's revenue is down by 50% during the year compared to the previous year. Although it has made a marginal gross profit, operating losses and net losses have been incurred during the year under review. Further, the industry is in a crisis situation and the cost of production has increased and prices of tea have come down. These conditions may indicate that the going concern of this company is in doubt. As a result, the management is in the process of determining an alternative strategy for this business. However, these are still under discussion and nothing has materialized.

Under the '**going concern assumption**' an entity is viewed as continuing in business for the foreseeable future. General purpose financial statements are prepared on a going concern basis, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. When the use of the going concern assumption is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

So, now the question is, if management is going to use the going concern assumption, whether it is appropriate. The auditor shall determine whether the financial statements adequately describe the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions. They shall also make sure the financial statements clearly disclose that there is a material uncertainty and, therefore, the entity may be unable to realise its assets and discharge its liabilities in the normal course of business.

If adequate disclosure is made in the financial statements, the auditor shall express an unmodified opinion and include an Emphasis of Matter paragraph in the auditor's report to:

(a) Highlight the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity's ability to continue as a going concern; and
(b) to draw attention to the note in the financial statements that discloses the Matter

If the financial statements have been prepared on a going concern basis, but in the auditor's judgment this is inappropriate, the auditor must express an adverse opinion. This applies regardless of whether the financial statements include disclosure of the inappropriateness of management's use of the going concern assumption.

(f) The view of Kasun, the audit senior of RPE regarding the increase in time cost of engagement by appointing a quality control review partner

E&F has established policies and procedures over quality control which must be in accordance with SLSQC 1. **Engagement performance is one aspect** these procedures need to consider. The main objective of appointing a quality control review partner is to **ensure the engagements are performed appropriately and in accordance with the standards (Sri Lanka Auditing Standards).** Appointing of a quality control review partner is a requirement for the audits of **listed companies**. Therefore, in performing the audit of Ruhunu Putra E&F is required to adhere to these policies and procedures.

The quality review partner has a role to play in the audit of RPE. The engagement partner is responsible for discussing significant matters arising with the quality control reviewer and for not issuing the audit report until the quality control review has been completed.

A quality control review should include:

- An evaluation of the **significant judgments** made by the engagement team
- An evaluation of the **conclusions** reached in formulating the auditor's report

Since RPE is a listed company, a quality control review for a listed entity will include;

- Discussion of significant matters with the engagement partner
- Review of financial statements and the proposed report
- Review of selected audit documentation relating to significant audit judgments made by the audit team and the conclusions reached
- Evaluation of the conclusions reached in formulating the auditor's report and consideration of whether the auditor's report is appropriate
- The engagement team's evaluation of the firm's independence towards the audit.
- Significant risks and judgements.
- Significances of corrections and uncorrected misstatements.

The above activities of the quality review partner would definitely require a sufficient time involvement in the audit and this will result in an increase in the time cost of the engagement. This will affect the engagement as well. That's the reason Kasun has a concern. However, there are benefits of appointing a quality control partner as it ensures the engagement quality by avoiding adverse effects. E&F needs to comply with the policies and procedures. Hence, Kasun needs to consider these aspects rather than commenting only on the cost increase.

(g) Appropriate assurance services

(1). Since the audited financial statements are available up to 31 March 2016, E&F can perform <u>a limited review on the financial results up to the quarter ended 30 June 2016</u>. Sri Lanka Standard on Review Engagements (SLSRE) 2400 *Engagements to review financial statements* contains guidance on review engagements and E&F could follow the guidance given in it.

The objective of a review engagement is to enable an auditor to state whether, on the basis of procedures which do not provide all the evidence that would be required in an audit, anything has come to the auditor's attention that causes the auditor to believe that the financial statements are not prepared, in all material respects, in accordance with an identified financial reporting framework.

(2) **Financial due diligence:** Financial due diligence is a review of the target company's **financial position, financial risk and projections**. It is not the same as a statutory audit. E&F can consider performing a financial due diligence for 30 June 2016 figures of Air Cooling (Pvt) Ltd.

(h) Role of forensic auditor

Forensic accounting is an undertaking of a financial investigation in response to a particular event, where the findings of the investigation may be used as evidence in court or to otherwise help resolve disputes. Since there is a fraud incident at RPS, the management can obtain the services of forensic accountant.

Forensic auditors have specific knowledge and competencies on fraud investigations as well as an investigative mindset and they will apply specific professional accounting and investigation skills.

The forensic auditor will do the investigation to assist management to:

- Quantify the losses incurred from the fraud incident at RPS including any commissions / bribes paid to third parties.
- Identifying the intentional misstatements in financial information, such as overstatement of revenue and earnings and understatement of costs and expenses

Forensic accountants may also be engaged to act in an advisory capacity to assist the directors of RPS in developing more effective controls to reduce the risks of fraud.

(Total 50 marks)

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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.

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