

CA



THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

KE4 – Processes, Assurance & Ethics

March 2016

SECTION 01

Answer 01

1.1

Learning Outcome/s: 1.1.3

Correct Answer C

1.2

Learning Outcome/s: 1.5.2

Correct Answer A

1.3

Learning Outcome/s: 2.1.3

Correct Answer D

1.4

Learning Outcome/s: 2.3.2

Correct Answer D

1.5

Learning Outcome/s: 2.4.1

Correct Answer D

1.6

Learning Outcome/s: 3.3.1

Correct Answer C

1.7

Learning Outcome/s: 3.2.1

Correct Answer C

1.8

Learning Outcome/s: 4.2.2

Correct Answer A

1.9

Learning Outcome/s: 5.5.2

Correct Answer D

1.10

Learning Outcome/s: 5.4.2

Correct Answer D

(Total: 20 marks)

Answer 02

2.1

Learning Outcome/s: 1.2.4

Stages in a risk management framework :

- Risk assessment/Risk identification
- Risk response : Risk treatment
- Monitor and review

2.2

Learning Outcome/s: 1.7.1

Inherent limitations

- a) Human error – This is where an officer forgets to carry out a particular control or may perform a control incorrectly
- b) Collusion between employees
This is where the employees work together in order to avoid achieving the control objective
- c) Management override
This is where a Manager uses his power and overrides compliance with the control
- d) Weak risk awareness culture in the organization
- e) Cannot prevent operational failures and errors
- f) Controls may be badly designed
- g) Controls may not be properly implemented
- h) Continuous changes and developments in the business environment
- i) Benefits do not justify the cost

2.3

Learning Outcome/s: 2.2.3

Business risks in the payroll of Silverline (Pvt) Ltd

- (i) Employee turnover of the company is high. Therefore there is a risk that payments are paid to employees who have resigned
- (ii) Employees are paid other payments in addition to the salaries (e.g. overtime, attendance allowance etc.). Therefore, there is a risk of calculating salaries and overtime incorrectly. This may result in either under or over payments to the employees.
- (iii) There is a risk of submitting incorrect payroll information by the HR department of the company which results in incorrect payments.

2.4

Learning Outcome/s: 2.5.1

Essential fields missed

- (i) Minimum quantity is not provided
- (ii) Value of each issue for each item
- (iii) Inventory balance (quantity, unit price and amount)
- (iv) Measure of quantity (kg's, litres etc.).

2.5

Learning Outcome/s: 2.4.2

- a) Acquisition of noncurrent assets/PPE which were not budgeted without appropriate approvals
- b) Disposal of noncurrent assets/PPE at a value less than market value without the required authorization
- c) Theft, loss or damage of noncurrent assets/PPE
- d) The risk that the accounting records for non-current assets are incorrect and discrepancies may exist in the accounting records.
- e) The risk that non-current assets cannot be found or do not exist.

2.6

Learning Outcome/s: 3.4.1

The main deficiency is the lack of segregation of duties in the above process. As a result, the Manager may commit a fraud in collusion with the supplier where the manager can approve invoices for undelivered goods.

2.7

Learning Outcome/s: 3.1.1.

Reasons for design ineffectiveness

- (i) Risks are identified for routine operations but not identified for non-routine situations.
- (iii) Controls are not automated, but require manual intervention by an individual
- (iv) The control measure is not sufficient to achieve its purpose / objective

2.8

Learning Outcome/s: 4.2.3	
a)	<u>Self-interest threat</u> This is <u>when an accountant's personal interest may influence his judgment and behaviour.</u>
b)	<u>Familiarity threat</u> An accountant may <u>become too sympathetic due to personal relationships.</u> This may <u>threaten the objectivity</u> of the accountant
c)	<u>Intimidation threat</u> An accountant may be <u>threatened of not being appointed as the auditor in future</u> if he tries to form a qualified opinion which is the right opinion
d)	<u>Self review threat</u> if review or re-evaluate work they have done or a judgment made in the past
e)	<u>Advocacy threat</u> promote a position or opinion in support of a client or employer

2.9

Learning Outcome/s: 5.1.2	
Three parties involved in an assurance engagement	
(i)	<u>Intended users</u> – These are the persons, person or class of persons <u>for whom the practitioner prepared the assurance report</u>
(ii)	The <u>responsible party</u> – the person (or persons) <u>responsible for the subject matter</u> or subject matter information of the assurance engagement. This is <u>usually a company</u> that engages the assurance practitioner to carry out an assurance engagement
(iii)	<u>The practitioner</u> – the <u>individual providing professional services</u> that will review the subject matter and provide the assurance

2.10

Learning Outcome/s: 5.5.3	
i)	Inspection
ii)	Observation
iii)	Inquiry and confirmation
iv)	Re-performance
v)	Analytical procedures
vi)	Re-calculation

(Total: 30 marks)

SECTION 2

Answer 03

Relevant Learning Outcome/s: 1.4.1/1.9.1

(a)

- Risk avoidance – this removes the possibility of a negative risk outcome. All risks cannot be avoided. To avoid risks, the management may refrain from making risk decisions on new investments, developing new products etc.
- Risk acceptance- Accepting the existing amount of risks, without the need for further measures to treat the risk. For instance, after considering the benefits/rewards the management may accept certain risks, e.g. in the economy there is an increase in the interest rate. However, in the long term there is an expectation of a reduction in the interest rate. Therefore management may borrow at a variable rate.
- Risk transfer – Transferring the risk to someone else. Insurance is a very common measure taken by many business organisations to transfer risk. (insurance on fire, disaster etc.)
- Risk reduction – Management may decide to reduce the risk if it is too high and unacceptable. The methods of reducing risk depends on the nature of the risk. For instance diversification of operations, business contingency planning are a few ways of reducing risks.

(b) (i)

Board of directors

The board of directors of STPL is the governing body of STPL. The directors have final responsibility for the effectiveness of the internal controls of STPL. This means the board of directors are ultimately responsible to the shareholders of STPL

The board of directors of STPL has a responsibility to ensure that the company has an effective control system in order to safeguard the investments and the assets of STPL. In discharging its responsibility the board may get the assistance of the internal auditor to ensure that the controls are operating effectively.

(ii). **Internal auditor**

The internal auditor provides management with information and recommendations about internal controls. He/she does not have direct responsibility for internal controls of STPL.

Internal auditors investigate control systems and report to the board of directors of STPL (as per information provided in scenario) on findings and recommendations. These testing and the areas of testing are determined as per the agreed plan with the board of directors.

(Total 10 marks)

Answer 04

Relevant Learning Outcome/s: 4.2.1/2.1.2

- (a) (i) **Ethical behaviour of professional accountant.**
- i) The accountancy profession requires members to provide services to the public according to certain standards. The profession's reputation and standing will be protected only if the members adhere to the expected standards. If the standards are not adhered to in providing services, and as a result, if a low quality service is provided it will have a negative impact on the entire profession.
 - ii) Another reason as to why a member should behave ethically is that unethical behaviour may result in disciplinary action being taken by the professional body which may lead to expulsion from the membership. This situation may negatively affect a member's future career.
 - iii) Ethical behaviour includes compliance with the law of the country. If a member violates the law of the country he may be prosecuted and charged by law enforcing authorities. Such an outcome will have a negative impact not only on the particular member but also to other members of the profession.
 - iv) Ethical behaviour serves to protect the public interest.
- (ii) Shamika is a member of CA Sri Lanka and therefore, as a professional accountant there is a high expectation in regards to his ethical behavior. Since he is dealing with the payment function of NPPL, he needs to ensure his duties are discharged as a professional accountant in a trustworthy manner. Money and the payment function are two aspects of the NPPL business where fraud and other crimes are most likely to occur. For instance there is a possibility of making fraudulent payments, excessive payments by oversight etc. Payments may be made for activities that are not ethical (bribe). Therefore, Shamika needs to consider these aspects and behave ethically in discharging his duties as his employer needs to be able to trust Shamika with their money. Identification of the risk why ethics are required.
- (b) (i) Document 1 – Purchase order / Confirmation
Document 2 – Goods received note
- (ii) **Purposes of document 1 and 2**
Document 1 – Purchase order / Confirmation
Purpose:
The purchase order is prepared by the purchasing department and it is sent to the supplier. The authorized PO is used to place the order with the supplier. Via PO the supplier is informed about the items, quantity the entity requires.
- Document 2 – Goods received note**
Purpose:
Once the delivery of goods are accepted the store keeper prepares GRN to show the details of goods received. This is also matched with the goods received and to the original PO.

(Total 10 marks)

Answer 05

Relevant Learning Outcome/s: 5.2.1/5.3.2

(a) **Difference between a statutory audit and a review engagement**

1. Statutory audit can be used to give assurance to a variety of stakeholders on many issues. An audit required by statute involves a high degree of testing and therefore has a high cost.

The intended users of review reports receive sufficient assurance about an issue from a less detailed engagement. Such a review can provide a cost-efficient alternative to an audit where an audit is not required by law.

2. The external auditor provides a high, but not an absolute, level of assurance that the information audited is free of material misstatement. This is expressed positively in the audit report as “reasonable assurance”

The auditor provides a limited level of assurance that the information subject to review is free of material misstatement. This is expressed in the form of negative assurance.

- (b) DT is a limited liability company. Therefore, as per statutory requirements an audit of financial statements should be conducted.

- (i) The auditors of DT need to carry out the audit in accordance with Sri Lanka Auditing Standards (SLAuSs). Compliance with SLAuSs is compulsory when carrying out the audits of entities specified by the Sri Lanka Accounting and Auditing Standards Act, No. 15 of 1995.

The auditor complies with Sri Lanka Auditing Standards to:

- (ii) Express an audit opinion on the financial statements of the entity (auditee) hence, the auditor needs to meet the requirements of SLAuSs.

- (iii) The users of the audited financial statements have the knowledge that the auditor’s opinion is based on audit work that has been conducted in accordance with the standards of the audit profession. Hence, the users will know that they can rely on the financial statements which have been submitted by the entity.

Enhances public confidence in the external audit as there are standards, according to which the audits should be conducted.

(Total 10 marks)

Answer 06

Learning Outcome 3.3.1

- (a) General IT controls are different policies and procedures that support the effective functioning of applications controls. General IT controls usually cover the following areas.
- i) Operations in IT centers and networks
 - ii) Access security/password controls
 - iii) Changes to IT system and system maintenance/program change controls
 - iv) General rules and procedures for acquiring, developing and maintaining of application IT systems
 - v) System software acquisition
- (b)
- i) Password protection of programs
 - ii) Restricted access to server room
 - iii) Maintenance of program logs
 - iv) Storing of backup copies of files/programs
 - v) Viral checks
 - vi) Documentation and testing of program changes
 - vii) Disaster recovery procedures
 - viii) Segregation of duties
 - ix) Testing procedure using test data
 - x) Approval of new applications by users and management
 - xi) Installation procedures
 - xii) Password protection of programmes
 - xiii) Backup copies of programmes
 - xiv) Protection of equipment against fire and other hazards
 - xv) Maintenance agreements and insurance.
- (c) Application IT controls are those that operate at a business process level. They are either preventive **or** detective **in** nature. They relate to procedures at initial recording, processing and the reporting of transactions.
- (d)
- i) Digit verification
 - ii) Reasonableness test
 - iii) Existence check
 - iv) Character check
 - v) Mandatory fields
 - vi) Screen warnings
 - vii) One for one checking
 - viii) Manual checks to ensure input was authorized
 - ix) Programmed matching of input to an expected input control file
 - x) Permitted range (no transaction processed over or under a certain value)

(Total 10 marks)

SECTION 3

Answer 07

Learning Outcome 2.3.3/2.1.2/2.1.3

(a)

(i) Risks in cash management

- a) The cashier can collect cash without issuing a receipt in collusion with the customer who could be given a discount
- b) The cashier can understate the receipt where the washing of a lorry/bus would be receipted as a car wash
- c) Non deposit of collection (theft)
- d) Security risk – cash in transit

(ii) Two controls –

- a) A register should be maintained by washing staff to record the details of the vehicles.
- b) Another independent employee should check the receipts with the vehicles recorded in the register
- c) Bank reconciliation
- d) Daily report of collection and banking- cash summary

(iii) Two purposes

- a) It will help determine all the cash receipts and payments during a given period
- b) It will help in the preparation of periodic financial statements for the business

(b)

(i) **Importance of a purchase requisition**

- The purchases are being made centrally. The purchases should be made as per the requirements of each sales outlet. When the sales outlet submit the purchase requirements the purchase requisition is used as the authority to place a purchase order with a supplier.
- It is the formal request for the purchase of a quantity of a specified item required by each sales outlet. Based on the requisition the PO can be raised as per the requirement. This will avoid ordering of unnecessary items / unwanted purchases.

(ii) **Delivery of ordered products**

- The purchases are made centrally and the goods are directly delivered to the sales outlet. Therefore there is a risk of not delivering the ordered goods to the respective sales outlet.
- Risk of delivering of expired products/ products of low quality. There is a risk of delivering goods which have not been ordered by the sales outlet.
- Short supply or theft.

Physical safeguard of inventories

- The cosmetic items are easily moveable and these could be stolen. Hence, there is a risk of theft. The customers/outside and employees can easily take the items out without making the payment.
- The cosmetics generally have an expiry period. If those are not arranged properly to facilitate the movement of items that were produced first, there is a risk of holding products that have expired. This will be a cost to the entity.
- The items could be easily damaged when those are handled either by employees or customers. If the cosmetics are not properly arranged, the products will be damaged and Beauty cosmetics will have to incur a loss.
- Condition of the storage facility e.g. temperature control.

(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).
