SRI LANKA

Association of Accounting Technicians of Sri Lanka

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Questions and Suggested Answers
Subject No : 34

PROCESSES, CONTROLS AND AUDIT
(PCA)

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EDUCATION AND TRAINING DIVISION

AA3 Examination - January 2016
(34) Processes, Controls and Audit

SUGGESTED ANSWERS

SECTION – A

Objective Test Questions (OTQs)
(20 Marks)

Suggested Answers to Question One:

(a) (1) Integrity.

(2) Objectivity.

(3) Professional competence.

(4) Due care.

(5) Confidentiality.

(6) Professional behavior.

(b) (1) Self-interest.

(2) Self-review.

(3) Advocacy.

(4) Familiarity.

(5) Intimidation.

Suggested Answers to Question Two:

(a) Assurance engagements play an important role in <u>providing users</u> of financial information confidence that the information is <u>reasonably accurate</u> and has been <u>properly prepared and presented.</u>

(b) (1) Special purpose financial statements.
(2) Assurance on adequacy of internal controls.
(3) Assurance on environmental matters.
(4) Assurance on regulatory compliance.

Suggested Answers to Question Three:

(a) According to SLAuS 580, the auditor required to obtain management representation in the following instances:
(1) To confirm management's responsibilities, where they are required by other SLAUSs.
(2) To support other audit evidence relevant to the audit.

(b) The senior auditor should advice the junior auditor to perform alternative audit procedures to obtain relevant and reliable audit evidence.
The senior in charge should direct the junior auditor to check subsequent cash receipts from those debtors, and if no subsequent receipts, testing of delivery documents if necessary.

Suggested Answers to Question Four:

(a) (1) Check whether Invoices / receipts are in serial order.
(2) Check whether an independent person check the daily banking deposits against the daily receipts summary/ totals.
(3) Check whether duties are adequately segregated between maintaining master data, invoicing, banking and checking of banking, general ledger entries posting.
(4) Check whether surprise cash counts are performed.
(5) Check whether access to amend master data, pricing are restricted.
(6) Check whether invoice cancellations / credit notes are approved.

(b) (1) Re calculation of correct amounts in the invoices.
(2) Check whether receipts are banked daily.
(3) Check whether price changes have been correctly updated.

(4) Obtain the quantity reconciliation summaries for selected items. i.e. check the opening balances of units add purchases and deduct the closing balances units and arrive for sold units and check whether this amounts tally with the actual sold no of units.

(5) Cut-off procedures.

(6) Check the bank reconciliation to identify whether there are any unusual long outstanding receipts.

(7) Check whether any deposit clearing accounts have any long outstanding items, representing undeposited sales proceeds.

For credit sales – verify the subsequent settlements.

(8) Call confirmation for debtor balances.

(9) Check for approval for bad debts etc.

End of Section A

SECTION –B

Short Scenario Questions (SSQs)

(30 Marks)

Suggested Answers to Question Five:

(a) (1) Major changes in the client's business, organization or accounting systems.

(2) Changes in law, accounting standards or the firm's procedures.

(3) Other relevant background information.

(4) Problems encountered in previous years and other points brought forward.

(5) Current tax position.

(6) Time and cost budgets and staffing plans.

(7) Time table and accounting assistance from the client.

(8) Overall audit strategy.

(9) Detailed audit approach for major areas.

(b) (1) The permanent audit file where information of counting importance to the audit is kept.

(2) Audit working papers from the previous audit file.

(3) Information from the client's website.

(4) Publications or websites related to the industry the client operates.

(c) (1) Check whether management procedures to identify slow moving inventory lines are designed well and whether they are operating effectively.

(2) Increase the emphasis on reviewing the year end aged inventory analysis for evidence of slow moving inventory.

(3) Ascertain sales values of the items sold in the yearend and the value of the inventory at the year end to check whether their NRV was higher than the cost recorded in the financial statements. Because there is a risk that the inventory value of an item may be much more higher than the actual selling price of that item.

Suggested Answers to Question six:

(a) (1) Risk Assessment - Identification Analysis & Evaluation.

(2) Risk Response.

(3) Monitor & review.

(b) **Importance of physical inventory verification:**

(1) The information about the inventories of FG PLC is highly important for operational decision making. Therefore, maintaining accurate and update inventory records are essential (fast moving goods).

(2) For that regular inventory verification should be done and compared with existing records of the entity. It enables management to identify and investigate the discrepancies in inventory quantities between physical quantities and stock records.

(3) More timely action could be taken on identified stock differences.

Transaction	Assertion	Audit test
Sales	Cut-off	Sales cut-off testing – check last 5 invoices of the current financial year and first 5 invoices or perform analytical review.
Accounts receivable	R/O	Reviewing for evidence that items belongs to the company. For e.g. examining the invoices, dispatch notes issued to check whether those documents are addressed to the relevant debtor.
Accounts payable	Existence	Check for supplier invoices against the GRNs.
Marketing expenses	Occurrence	Check subsequent settlements of accounts payable.
Lands	Existence	Inspection of supporting documents for incurring of marketing expenses.
		Check for the deed of the particular land to verify that the land/deed is named in the Company's name.

Suggested Answers to Question seven:

(a) (1) Controls may not be well designed.

(2) Controls may not be implemented as required. Therefore, even a well-designed control may not be able to achieve its objectives.

(3) Continues changes in operational risks. As a result, pre designed controls may fail to address the new risks.

(4) Cost of designing and implementing controls does not justify the benefits delivered from those controls.

(5) Poor risk awareness culture within the organization.

(6) Non routine transactions are not covered.

(7) Human error.

(b)

Preventive control	Comparing goods receipts with the invoices received from suppliers to confirm that data are matching and therefore, the payments are made only for those goods which have been received.
Detective control	Perform monthly supply statement reconciliation. Will be able to identify any discrepancies arisen and take corrective actions.

(c) **Internal control weakness:**

(1) No process of evaluating new suppliers before selection.

(2) There had been no controls to confirm whether all goods are delivered to the intended place / sales outlet.

(3) No process to use excess stock of one outlet to transfer it to an outlet with shortages.

(d) **Recommendations:**

(1) New suppliers should be evaluated before selecting and it should be done according to a pre-determined process.

(2) Outlets should be informed of the scheduled deliveries, any unscheduled deliveries should be cleared with purchasing department before accepting those to respective outlet.

(3) Shortages in an outlet should be informed to the purchasing department. The purchasing department should evaluate whether there is a surplus in another outlet so that the surplus could be transferred to the outlet with a shortage.

End of Section B

SECTION –C

Medium Sized Scenario Questions (MSQs).

(Total = 50 marks)

Suggested Answers to Question Eight:

(a) (1) **Direction:**

At the planning stage, but also during the audit, the engagement partner ensures that the members of the engagement team are informed of:

- Their responsibilities.
- The objective of the work to be performed.
- The nature of the entity's business.
- Areas that require special attention.
- Problems that may arise.
- Detailed approach to the audit engagement.

(2) **Supervision:**

Supervision is closely related to both direction and reviews and may involve elements of both. Supervision include:

- Tracking the progress of the audit engagement.
- Consider the capabilities of individual members of the engagement team and they understand their instructions.
- Addressing issues that arise and modifying the audit approach if appropriate.
- Identifying matters for consultation or consideration by more experienced members of the audit engagement.

(3) **Review:**

This refers to the inspection of work done by engagement members by more senior members of the same engagement. This includes ensuring that:

- The work has been performed in accordance with the audit program.
- The work performed and the result obtained have been adequately documented.
- All significant audit matters have been resolved or are reflected in audit conclusions.
- The objectives of the audit procedures have been achieved.
- The conclusions expressed are consistent with the results of the work performed and support the audit opinion fundament.

(b) (i) **Areas that need special attention in performing audit procedures:**

(1) Having outstanding balances over 91 days.

(2) Suspense receivable balance of Rs.240,500/-.

(3) Cash sales balance is also appearing in the "Debtors Age Analysis".

(4) Bank guarantees have not been collected from the recently appointed distributors.

(5) Saman Pharmacy has a credit balance.

(6) Palam Stores has an outstanding balance of Rs.278,600/- which is more than 91 days.

(ii) **Reason each for considering those areas stated in (i) above:**

(1) Having outstanding balances over 91 days:

As per the company policy, credit period is 30 days. Should check the recoverability of long outstanding debtors. The provision for doubtful debtors may be understated.

(2) Suspense receivable balance of Rs.240,500/-:

The nature of the suspense receivable should be checked to determine its existence and recoverability.

(3) Cash sales balance is also appearing in the "Debtors Age Analysis":

Cash sales should not be receivable.

(4) Bank guarantees have not been collected from the recently appointed distributors:

The reason for not collecting bank guarantees from these people as it increases the credit risk?

(5) Saman Pharmacy has a credit balance:

The nature of the credit balance must be checked to determine whether it relates to the receivable or whether it is a payable.

(6) Palam Stores has an outstanding balance of Rs.278,600/- which is more than 91 days:

This customer has not done transactions recently and outstanding balances too has not settled. Is this balance recoverable ? Is there any dispute over this balance. This may be required to write off as bad debt

(iii) **Matters to be considered when selecting a sample of accounts receivables:**

(1) Since the no. of items included under other debtors is 34 and this includes high value items, non-statistical sampling approach is much better in selecting the sample items for this scenario.

(2) Kanishka can select high value items (Alpha and Sameera) and Unusual or prone to error items (Palam & Saman Pharmacy)

(3) Further it is necessary to select lower value items too in order to represent the full population.

(iv) **If the Management refuses to allow the auditor to send confirmation requests to Sameera Pharmacy and Alpha Pharmacy, the auditor shall:**

(1) Inquire the reasons for the refusal and seek audit evidence as to their validity and reasonableness

(2) Evaluate the implications of management's refusal on the risk of fraud and on the nature, timing and extent of other audit procedures

(3) Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

(4) If the auditor concludes that managements refusal is unreasonable, the auditor shall communicate with those charged with governance of the company and response on the risk associated with the management refusal.

(c) (1) Description of the working paper not given.

(2) The preparer of the working paper not given.

(3) Details of the sample selected.

(4) How the sample was selected.

(5) The detail tests performed on the additions.

(6) No reference to any supporting documents of the additions.

(7) Findings are not documented.

(8) Conclusion is not provided.

Suggested Answers to Question Nine:

(a) (i) (1) **Qualified opinion** – When the auditor finds that the misstatement is material but not pervasive and when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion but concludes that the possible effects of undetected misstatement, if any, could be material but not pervasive.

(2) **Disclaimer of opinion** – When the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion and concludes that the possible effects on the financial statements of undetected misstatements, if any could be both material and pervasive.

(3) **Adverse opinion** – The auditor obtains appropriate audit evidence. But concludes that misstatements, individually or in aggregate, are both material and pervasive to the financial statements.

(ii) **Errors noted in the audit report prepared:**

(1) The addressee of the report not given: Since this is a private limited company, usually it addresses to the owners of the company. i.e. shareholders.

(2) The period that is covered from the financial statements is not provided in the first paragraph of the report (introductory paragraph)

(3) The introductory paragraph does not provide reference to accounting policies and other notes to the financial statements

(4) Management responsibility paragraph has not recognized that the management's responsibility for maintaining internal controls relevant to the preparation of the financial statements.

(5) Auditor's responsibility paragraph does not refer to Sri Lanka Auditing Standards, where the auditor should confirm that the audit was conducted in accordance with those standards.

(6) Opinion paragraph does only mention about the financial position (at which date also not stated) not the other statements on financial performance of the company (comprehensive income statement) with the period covered.

(7) Opinion paragraph has not referred to the accounting framework – whether the financial statements provide true and fair view in accordance with Sri Lanka Accounting Standards (which is the accounting framework)

(b) (i) **Benefits of preparing bank reconciliations:**

(1) The management will be able to identify the errors of both the bank (any wrong amounts or transactions recorded) and the entity (in maintaining the cash book)

(2) When the bank reconciliations are prepared, the management will be able to identify the updates required to the cash book such as bank charges, debit tax etc.

(3) It is an important internal control over cash at bank balances of the company and related transactions. Any fraudulent activity may be detected when preparing bank reconciliations.

(4) It helps management to get an idea of the cheques not presented to the bank and cheques not realized, thereby to understand the amount of cash that should be maintained in the bank account in the future to meet such expenses.

(ii) (1) Issued But not presented cheques.

(2) Unidentified debit of Rs. 70,000/-.

(3) 24Th June Deposit of Nayomis Rs. 358,400/- cheque.

(4) Direct deposit of Rs.75,800/- too needs to be identified.

(5) Cash deposit of Rs. 100,000/- on June 28th.

(6) Kameel's cheque dated 01.10.2015 for Rs.75,800/- included in the Bank Reconciliation prepared as at 30.06.2015.

(iii) Areas need special attention:

(1) Issued But not presented cheques:

Below cheques have been issued before six months. Generally after six months cheques can not be presented. It is necessary to check why these cheques have not been presented yet. If these are not payables it is necessary to reverse.

Date	Cheque No.	Supplier Name	Amount (Rs.)
12.10.2014	421356	Sisira (Pvt) Ltd	125,000
11.11.2014	421389	Kamal Stores	356,800

(2) **Unidentified debit of Rs. 70,000/-:**

This needs to be checked immediately. This may be a guarantee fee or standing order. If not immediately needs to identify what this is.

(3) **24Th June Deposit of Nayomis Rs. 358,400/- cheque:**

Usually it takes 2 working days to realize a cheque. But here even after 6 days this cheque has not got realized. Reason needs to be identified

(4) **Direct deposit of Rs.75,800/- too needs to be identified:**

Related balances will be misstated.

(5) **Cash deposit of Rs. 100,000/- on June 28th:**

Cash will get credited to account on the same time it deposit. Reasons needs to be identified for this. This may indicate that cash have been misused by somebody.

(6) **Kameel's cheque dated 01.10.2015 for Rs.75,800/- included in the Bank Reconciliation prepared as at 30.06.2015:**

Reason for having this date in the cheque. Why it is issued? Who are the signatories of this cheque? This may indicate that cash have been misused by somebody.

End of Section C

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