



ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

LEVEL III EXAMINATION - JULY 2021

(303) FINANCIAL CONTROLS & AUDIT

- **Instructions to candidates** (Please Read Carefully):
 - (1) **Time Allowed:** Reading : 15 minutes.
Writing : 03 hours.
 - (2) **All questions should be answered.**
 - (3) **Answers should be in one language, in the medium applied for, in the booklets provided.**
 - (4) **Submit all workings and calculations. State clearly assumptions made by you, if any.**
 - (5) **Use of Non-programmable calculators is only permitted.**
 - (6) **Action Verb Check List with definitions is attached. Each question will begin with an action verb. Candidates should answer the questions based on the definition of the verb given in the Action Verb Check List.**
 - (7) **100 Marks.**

23-10-2021

Afternoon

[01.45 – 05.00]

No. of Pages : 08

No. of Questions : 09

SECTION A

(Total 20 marks)

Question 01

The objective of the assurance engagement is to provide an assurance to the intended users of the information. There are two types of assurance engagements as reasonable assurance engagements and limited assurance engagements.

You are required to:

- (a) **State** three(03) differences between a reasonable assurance engagement and a limited assurance engagement. (03 marks)
 - (b) **State** two(02) examples for assurance engagements other than the statutory audit. (02 marks)
- (Total 05 marks)

Question 02

Agency theory argues that shareholder interests require protection by separation of incumbency of roles of board chair and CEO, while stewardship theory argues that shareholder interests are maximized by shared incumbency of these roles.

You are required to:

Explain the difference between agency theory and stewardship theory. (05 marks)

Question 03

AB PLC is operating in the leisure sector. Due to COVID-19 pandemic, the company faced difficulties for its operation. The following information is extracted from the risks recognized by the risk management framework adopted by the company.

| Key Risks | Risk Rating |
|---|-------------|
| Macroeconomic and political environment | High |
| Regulatory environment | High |
| Information technology | High |
| Competition | Low |
| Human resources management | Low |
| Environment and health & safety | High |
| Reputation and brand image | Low |

You are required to:

Assess the following risk areas of **AB PLC** as an organization operating in the leisure sector:

(a) Risk in Operations.

(b) Compliance Risk.

(05 marks)

Question 04

The firm promotes consistency in the quality of engagement performance through its policies & procedures and the engagement partner is ultimately responsible for quality control of individual engagements.

You are required to:

(a) **State** two(02) matters to be addressed in maintaining the consistency in the quality of engagement performance. (02 marks)

(b) **State** three(03) matters to be considered when reviewing the audit work. (03 marks)
(Total 05 marks)

End of Section A

SECTION B

(Total 30 marks)

Question 05

You are the audit senior at **Suraj & Company**, a firm of Chartered Accountants with two partners; **Suraj** and **Anil**. Your firm is the auditor of **Fen Trading (Pvt) Ltd. (FTL)** for last 25 years and you are involved in this company's audit for past 6 years. Managing Director of **FTL** sponsored gift vouchers and 2 days stay at a 5 star hotel for the entire audit team during the audit to celebrate the silver jubilee.

During the silver jubilee celebration, Managing Director of **FTL** informed about planned private placement to be held in the next year to improve capital base and your manager agreed to find a suitable investor. Managing Director informed that, if **Suraj & Company** is succeed to find a potential investor, they will increase the audit fee by 20%.

You are required to:

- (a) **Explain** three(03) threats to compliance with the fundamental principles of ethics with reference to the above scenario. (06 marks)
 - (b) **State** four(04) firm-wide safeguards to be implemented by **Suraj and Company** to minimize the threats identified in (a) above. (04 marks)
- (Total 10 marks)

Question 06

Vimal was assigned as an audit Manager for the first time for a new audit client, **Roy Hotels (Pvt) Ltd. (RHL)**. The audit partner, **Siva** informed that nothing has been done so far and audit of the financial statements of the **RHL** for the year ended 31st March 2021 to be commenced in next month. **Siva** requested to assist preliminary engagement activities specially matters relating to initial audit. Further, **Siva** informed that, audit documentation is to be included in audit software and working papers completed by two associates should be reviewed. **Vimal** is planning to have a discussion with two associates regarding the audit documentation.

You are required to:

- (a) **Explain** two(02) specific procedures that should be performed by **Vimal** in relation to the above initial audit before commencing the audit. (04 marks)
 - (b) **Explain** the primary purpose of the Audit Documentation. (03 marks)
 - (c) **List** three(03) information included in the working papers of audit documentation. (03 marks)
- (Total 10 marks)

Question 07

Sena & Company, a firm of Chartered Accountants is the auditor of **Rama PLC** for the year ended 31st March 2021 and the materiality for the audit which was determined based on the profit before tax was Rs.900,000/-.

The following information was extracted from the audit documentation:

Findings:

- (1) The company started to construct an office building during the year by obtaining a specific bank borrowing. The total amount of interest incurred on the loan during the year was Rs. 5 million and it was recorded as finance expenses in the Comprehensive Income Statement. The construction of the building will be completed in December 2021 and total cost incurred during the year on that construction was Rs. 65 million.
- (2) The bank reconciliation statements for the months from September 2020 to February 2021 were not reviewed by the Accountant.
- (3) During the year, monthly payroll summary prepared by HR Executive is not reviewed by HR Manager.
- (4) Item number (2) above was a finding reported in the audit's finding of previous year as well.

Communication:

The Audit Manager has discussed these findings with the Assistant Accountant of **Rama PLC**.

You are required to:

- (a) **Explain** two(02) matters that the auditor should communicate with management and those charged with the governance as per the information provided in the above scenario.
(04 marks)
- (b) **Assess** the impact of the matter included in (1) above under findings, on the audit opinion of Auditor's report on the Financial Statements for the year ended 31st March 2021.
(06 marks)
(Total 10 marks)

End of Section B

SECTION C

(Total 50 marks)

Question 08

Malaka (Pvt) Ltd. is a family-owned business with 200 factory employees engaged in manufacturing of garments for European market. The company's payroll related process study revealed the following.

- (1) HR Department consists of HR Manager & HR Assistant and Finance Department consists of an Accountant & an Accounts Executive.
- (2) Attendance of Employees are recorded in a manual book kept at the entrance.
- (3) Monthly payroll is prepared by the HR Assistant based on the manual attendance records.
- (4) All payroll related amendments are made by the HR Assistant.
- (5) Payments are made to respective bank accounts of employees and instructions for the salary transfer are prepared by the Accounts Executive and it is approved by the Director.
- (6) Payroll records are kept at a common area in Finance Department.
- (7) There are 5 production lines in the factory and each line is supervised by the Factory Supervisor, who maintains job schedules in the factory, such as entry to the factory, exit from the factory and output produced by each employee.
- (8) Director reviews the headcount in payroll summary with job schedules.
- (9) Payroll related accounting entries are posted to ledger accounts by the Accounts Executive.
- (10) During the year, the company has made changes to its General Ledger (GL) module and these changes were made by the Accounts Executive.

You are required to:

- (a) **Recognize** three(03) elements of control activities that were not designed properly by **Malaka (Pvt) Ltd.** with an example for each internal control weaknesses. (06 marks)
- (b) **State** three(03) recommendations to overcome the above weaknesses of payroll process. (03 marks)
- (c) **Explain** three(03) benefits of implementing Internal Control system within an Organization. (06 marks)
- (d) **State** steps of payroll process in the payroll system. (04 marks)
- (e) **List** four(04) controls that can be implemented over prevention or detection of unauthorized changes to programs and two(02) controls that can be implemented to prevent unauthorized amendments to data file. (06 marks)

(Total 25 marks)

Question 09

You are the Audit Senior of **DSK Associates**, a firm of Chartered Accountants. Due to the impact of COVID-19, your audit manager has instructed to minimize the travelling and use online activities to perform audits.

You have received a mail from **SM Holdings (Pvt) Ltd.** which is engaged in purchasing and wholesale of ready-made garments. The following Statements of Financial Position and the schedules were attached in that mail:

(1) Statements of Financial Position: (Rs.'000)

| | As at 31 st March 2021 | As at 31 st March 2020 |
|---|-----------------------------------|-----------------------------------|
| Property, Plant & Equipment at carrying value | 231,831 | 125,550 |
| Current Assets: | | |
| Inventories | 84,340 | 20,660 |
| Trade Receivables | 102,571 | 60,390 |
| | 418,742 | 206,600 |
| Equity: | | |
| Stated Capital | 80,000 | 80,000 |
| Retained Earnings | 39,410 | 24,210 |
| Current Liabilities: | | |
| Bank Loans | 141,390 | 55,410 |
| Trade Payables | 121,390 | 45,930 |
| Other Payables | 36,552 | 1,050 |
| | 418,742 | 206,600 |

(2) Details of Property, Plant and Equipment: (Rs.'000)

| | Cost | Additions/ (Disposals) | Accumulated Depreciation as at 31 st March 2021 | Balance as at 31 st March 2021 |
|------------------|----------------|---------------------------|--|--|
| Land & Buildings | 152,576 | 89,300 | 24,200 | 217,676 |
| Motor Vehicles | 18,980 | - | 4,825 | 14,155 |
| Total | 171,556 | 89,300 | 29,025 | 231,831 |

(3) Trade Receivables' Age Analysis: (Rs.'000)

| Name | Total | 0-30 days | 30-60 days | 60-90 days | Over 90 days |
|-------------------|----------------|---------------|---------------|---------------|---------------|
| Danushka Fashions | 26,831 | 2,855 | - | - | 23,976 |
| Shiran Fashions | 41,325 | 14,610 | 14,550 | 12,165 | - |
| Kamil Textiles | 7,580 | 7,580 | - | - | - |
| SJ Garment | 4,011 | - | 4,011 | - | - |
| Lakshmi Garment | 21,357 | 6,822 | (955) | 12,153 | 3,337 |
| Synergy Tex | 1,467 | - | - | - | 1,467 |
| | 102,571 | 31,867 | 17,606 | 24,318 | 28,780 |

(4) Extracts from Income statements:

(Rs.'000)

| For the year ended 31st March | 2021 | 2020 |
|---|---------------|---------------|
| Sales | 175,300 | 164,210 |
| Cost of Sales | (147,290) | (131,350) |
| Gross Profit | 28,010 | 32,860 |
| Expenses | (12,810) | (11,700) |
| Net Profit before Tax | 15,200 | 21,160 |

The following additional information has also been given:

- (1) Last year working papers indicate that **Lakshmi Garment** is a related party entity of **SM Holdings (Pvt) Ltd.** It belongs to **Mrs.Kularathna** who is the wife of the Managing Director of **SM Holdings (Pvt) Ltd.**
- (2) Number of transactions of **SM holdings (Pvt) Ltd.** is low for the year under review and therefore, the engagement partner has instructed you to approach with non-statistical sample.

You are required to:

- (a) **Identify** five(05) areas that you need to inquire and collect further audit evidences from the above reports. (05 marks)
 - (b) **State** three(03) types of audit procedures other than audit inquiries to be used for obtaining audit evidences with an example for each. (06 marks)
 - (c) **List** five(05) audit procedures need to be performed in auditing Property, Plant and Equipment of **SM Holdings (Pvt) Ltd.** (05 marks)
 - (d) **State** five(05) audit procedures that you need to perform regarding related party transactions of **SM Holdings (Pvt) Ltd.** (05 marks)
 - (e) **Explain** two(02) examples of circumstances where the auditor may consider it necessary to include an emphasis of matter paragraph. (04 marks)
- (Total 25 marks)

End of Section C

ACTION VERBS CHECK LIST

| Level of Competency | Description | Action Verbs | Verb Definitions |
|----------------------|----------------------------------|-----------------|---|
| Knowledge (1) | Recall Facts and Basic Concepts. | Draw | Produce a picture or diagram. |
| | | Relate | Establish logical or causal connections. |
| | | State | Express details definitely or clearly. |
| | | Identify | Recognize, establish or select after consideration. |
| | | List | Write the connected items. |

| Level of Competency | Description | Action Verbs | Verb Definitions |
|--------------------------|---|------------------|---|
| Comprehension (2) | Explain & Elucidates Ideas and Information. | Recognize | Show validity or otherwise, using knowledge or contextual experience. |
| | | Interpret | Translate into understandable or familiar terms. |
| | | Describe | Write and communicate the key features. |
| | | Explain | Make a clear description in detail using relevant facts. |
| | | Define | Give the exact nature, scope or meaning. |

| Level of Competency | Description | Action Verbs | Verb Definitions |
|------------------------|--|--------------------|---|
| Application (3) | Use and Adapt Knowledge in New Situations. | Reconcile | Make consistent / compatible with another. |
| | | Graph | Represent by graphs. |
| | | Assess | Determine the value, nature, ability or quality. |
| | | Solve | Find solutions through calculations and/or explanation. |
| | | Prepare | Make or get ready for a particular purpose. |
| | | Demonstrate | Prove or exhibit with examples. |
| | | Calculate | Ascertain or reckon with mathematical computation. |
| | | Apply | Put to practical use. |

| Level of Competency | Description | Action Verbs | Verb Definitions |
|---------------------|--|----------------------|---|
| Analysis (4) | Draw Connections Among Ideas and Solve Problems. | Communicate | Share or exchange information. |
| | | Outline | Make a summary of significant features. |
| | | Contrast | Examine to show differences. |
| | | Compare | Examine to discover similarities. |
| | | Discuss | Examine in detail by arguments. |
| | | Differentiate | Constitute a difference that distinguishes something. |
| | | Analyze | Examine in details to find the solution or outcome. |