

**ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA**  
**LEVEL III EXAMINATION - JANUARY 2022**  
**(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.**

19-03-2022

Afternoon

[01.45 – 05.00]

No. of Pages : 07

No. of Questions : 09

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**SECTION A**

(Total 20 marks)

**Question 01**

Corporate Governance is the system by which the companies are directed and controlled. It is important in the organizational context because it always links with what the organization plans to achieve by implementing a good Corporate Governance System. An organizational structure with a proper reporting structure is one of the key components of an organization's Governance Framework.

**You are required to:**

- (a) **Identify** three(03) advantages to a company following the good Corporate Governance system. (03 marks)
  - (b) **State** two(02) components of organization's Governance Framework other than organizational structure. (02 marks)
- (Total 05 marks)

**Question 02**

For a business organization a risk is the possibility that actual results will differ from what was expected. Business risks are typically categorized as internal risks and external risks.

**You are required to:**

**Explain** two(02) internal risks faced by an organization with an example for each. (05 marks)

### Question 03

**SJ (Pvt) Ltd.** (“the company”) engages in manufacturing of compost fertilizer for agricultural sector. The management has decided to increase the capacity by investing in new machinery and intends to take a concessionary loan from a state bank. For this purpose, the accountant of the company has prepared a 5 years’ forecast and presented to the bank. The bank has requested to present it with an Independent Auditor’s opinion.

**You are required to:**

**Relate** the elements of the assurance engagement to the above engagement. (05 marks)

### Question 04

As the COVID-19 pandemic continues to evolve, your audit firm has decided and agreed to implement certain processes when conducting audits. Most of these changes happened due to travel restrictions and advancement in the technology. During the recent audit meeting, the engagement partner insisted the team on the importance of maintaining audit quality in this present context and the firm shall employ personal with sufficient competence, capabilities and commitment to ethical principles.

**You are required to:**

(a) **Identify** two(02) methods that develop the competency of personal employed in the audit firm. (02 marks)

(b) **State** three(03) elements of a system of quality control that a firm should establish and maintain. (03 marks)

(Total 05 marks)

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*End of Section A*

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## **SECTION B**

(Total 30 marks)

### Question 05

You are an audit senior at **Perera & Co.** a firm of Chartered Accountants. Your firm is the auditor of **Happy (Pvt) Ltd. (HPL)** a 5 star hotel for last 5 years and you have engaged in this audit since last year. You are currently planning the audit for the forthcoming financial year as well.

During the planning meeting, your manager informed the following matters:

- The company has acquired a luxury apartment for Rs. 100 million from its Managing Director (MD) and provided it as accommodation for Chief Financial Officer (CFO), who is the spouse of MD.
- There was an adverse media publicity in the recent past that the CFO has misused the company’s assets.

**You are required to:**

- (a) **Explain** the term “Risk assessment procedures”. (02 marks)
- (b) **State** three(03) risk assessment procedures that can be performed by you in relation to **HPL**. (03 marks)
- (c) (i) **State** two(02) fraud risk factors that need to be considered by you in relation to **HPL**. (02 marks)
- (ii) **Explain** the auditor’s responsibility with reference to the prevention and detection of frauds in **HPL**. (03 marks)
- (Total 10 marks)

### Question 06

**Dulani** has just joined **YK Associates**, a firm of Chartered Accountants as an audit trainee after completing her Level I Examination of a professional accounting body. She was assigned the audit of **Saman Trading (Pvt) Ltd. (SPL)** and you are the Audit Executive of that audit. She was asked to perform audit procedures in relation to Property, Plant and Equipment. You briefed her about necessary audit procedures to be performed. However, she asked “Why auditors are required to carry out the audit with professional skepticism and professional judgment?” to have a better understanding.

**You are required to:**

- (a) **State** the difference between professional skepticism and professional judgment. (03 marks)
- (b) **Explain** two(02) financial statement assertions relevant to Property, Plant and Equipment. (04 marks)
- (c) **Explain** the overall objectives of the auditor. (03 marks)
- (Total 10 marks)

### Question 07

Most of the professional bodies have their Codes of Ethics. All members of professional bodies are required to comply with those ethical codes. Members of Association of Accounting Technicians of Sri Lanka (AAT Sri Lanka) also must comply with fundamental principles set out in the Code of Ethics of AAT Sri Lanka.

**You are required to:**

- (a) **Explain** three(03) fundamental principles of professional ethics applicable for members of AAT Sri Lanka. (06 marks)
- (b) **Explain** two(02) threats to compliance with the fundamental principles of ethics with an example for each. (04 marks)
- (Total 10 marks)

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*End of Section B*

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## **SECTION C**

(Total 50 marks)

### **Question 08**

**AB (Pvt) Ltd.** (“the company”) is engaged in providing consultancy services to clients in USA and Sri Lanka. Due to COVID-19 pandemic, the company has experienced a growth in the business. The following information is made available:

#### **Revenue and cash Management:**

- (1) Operations Department is responsible for identifying customer requirements, agree on terms and conditions, maintaining the agreements, raising invoices and delivering the services. It is led by Manager (Operations) and 5 Executives. Finance Department consists of a Manager (Finance), Accountant [General Ledger (GL)] and two Assistant Accountants.
- (2) The company has routine services such as maintaining General Ledger accounts and producing monthly statements to its customers. There are 100 customers with the standard agreements and based on respective agreement with the customer, the company entitles to provide monthly service and revenue (sales) is recognized in every 2 months.
- (3) All customers’ agreements are signed by Manager (Finance) and kept under the custody of Manager (Operations) in an open area. All invoices are being raised by an Executive at Operations Department. Then email the copy to the Accountant (GL), who posts this to journals in company’s financial system.
- (4) Manager (Operations) compares the budget with actual revenue in every 6 months and he performs reconciliation on number of invoices in General Ledger to number of invoices raised as per available customer agreements.
- (5) Some local customers are giving postdated cheques and those are kept with an executive in operations department till the date of the cheque. After that the executive hands over those cheques to an Assistant Accountant.
- (6) Bank reconciliation statement is prepared at the end of financial year by an Assistant Accountant.

#### **IT process:**

During the year, the company has internally developed a new invoicing system and deployed without test. Since, it is an internally developed software, no documentation is kept and the password for system login is shared between employees in the Operations Department. IT room can be accessed by anyone at office at any time. All master data are manually enters to the system by an Assistant Accountant. Monthly back-ups are kept at Manager’s (Finance) cabin. The company is not using firewalls.

**You are required to:**

- (a) **Define** the term “Internal Control”. (03 marks)
- (b) **Identify** five(05) internal control weaknesses in **AB (Pvt) Ltd.** in revenue and cash management. (05 marks)
- (c) **State** a recommendation each to overcome the above weaknesses. (05 marks)
- (d) **Explain** four(04) IT general controls that are **not** designed properly in the IT process of **AB (Pvt) Ltd.** with an example for each from the information provided. (08 marks)
- (e) **State** four(04) elements of control environment included in COSO Internal Control System. (04 marks)
- (Total 25 marks)

**Question 09**

**Sampath**, an Audit Senior at **Dil Associates**, a firm of Chartered Accountants engages in the annual audit of **Sam Ltd.** (“the company”), a company operating in the business of trading of consumer goods for the year ended 31<sup>st</sup> December 2021. The management has prepared the financial statements on the basis that the company is going concern in accordance with the Sri Lanka Accounting Standards.

The following information was received from the Finance Manager of the company:

**Statement of Financial Position** (Rs.'000)

As at 31 <sup>st</sup> December	2021	2020
<b>Non-Current Assets:</b>		
Property, Plant and Equipment at carrying value	13,909	15,634
<b>Current Assets:</b>		
Inventories (at cost)	44,493	40,417
Trade Receivables	102,284	94,199
Cash and Cash Equivalents	356	15,368
	147,133	149,984
<b>Total Assets</b>	<b>161,042</b>	<b>165,618</b>
<b>Equity:</b>		
Stated Capital	21,625	21,625
Retained Earnings	(35,655)	10,791
	<b>(14,030)</b>	<b>32,416</b>
<b>Non-Current Liabilities:</b>		
Term Loan	35,000	-
<b>Current Liabilities:</b>		
Amounts due to Related Parties	23,378	24,317
Trade Payables	69,057	53,250
Income Tax Payable	17,757	17,757
Bank Overdraft	29,880	37,878
	140,072	133,202
<b>Total Equity and Liabilities</b>	<b>161,042</b>	<b>165,618</b>

**Statement of Comprehensive Income** (Rs.'000)

For the year ended 31 <sup>st</sup> December	2021	2020
Revenue	72,970	141,294
Cost of Sales	(75,800)	(113,568)
<b>Gross Profit / (Loss)</b>	<b>(2,830)</b>	<b>27,726</b>
Distribution Expenses	(13,361)	(32,950)
Administration Expenses	(28,500)	(16,250)
Finance Expenses	(1,755)	(1,045)
<b>Profit / (Loss) before Tax</b>	<b>(46,446)</b>	<b>(22,519)</b>
Income Tax	-	-
<b>Profit / (Loss) for the Year</b>	<b>(46,446)</b>	<b>(22,519)</b>

**List of Trade Receivables**

	Rs. ('000)	Age
Milton Ltd.	67	30 days
Ken (Pvt) Ltd.	1,967	30 days
Roy (Pvt) Ltd.	20,967	90 days
Mac PLC	167	180 days
Samson (Pvt) Ltd.	45,767	720 days
Ms. Frank	33,349	1,460 days
	<b>102,284</b>	

The following details relating to the audit engagement was extracted from audit documentation:

- (1) The materiality applicable for the audit was Rs.1,600,000/-.
- (2) The company has obtained a bank loan during the year, and the company has breached the loan covenants. As per the loan agreement, breach of any covenant will result the loan to be paid on demand.
- (3) On 01<sup>st</sup> January 2022, the entire stock as at 31<sup>st</sup> December 2021 was sold for Rs.42,800,000/- and it was not adjusted in the financial statements for the year ended 31<sup>st</sup> December 2021.
- (4) The company has only accounted for 50% of the annual depreciation charge amounting to Rs.1,250,000/- during the year.

**You are required to:**

- (a) **Identify** five(05) areas that need special attention in performing audit procedures of **Sam Ltd.** (05 marks)
- (b) **State** four(04) factors to be considered in determining audit materiality. (04 marks)
- (c) **Discuss** the applicability of going concern assumption in preparing the financial statements of **Sam Ltd.** (05 marks)
- (d) **Assess** the impact of the above matters referred in (2) to (4) to the audit opinion of Auditors' Report on financial statements for the year ended 31<sup>st</sup> December 2021 of **Sam Ltd.** (07 marks)
- (e) **Explain** two(02) instances where the auditor shall modify the auditor's opinion in the Auditor's Report. (04 marks)

(Total 25 marks)

End of Section C

## **ACTION VERBS CHECK LIST**

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

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

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

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