



ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

LEVEL III EXAMINATION - JULY 2024

(303) FINANCIAL CONTROLS & AUDIT

• **Instructions to candidates** (Please Read Carefully):

- (1) **Time Allowed:** Reading : 15 minutes.
Writing : 03 hours.

10-08-2024
Afternoon
[01.45 – 05.00]

- (2) **All questions should be answered.**

No. of Pages : 06

No. of Questions : 09

- (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.**

SECTION A

(Total 20 marks)

Question 01

Tissera & Co. is the newly appointed auditor of **Neutral PLC**. During the first meeting with the Audit Committee, the Chairman of the audit committee mentioned about the “stewardship role” of the auditor.

You are required to:

Explain two(02) reasons why the audit is important for shareholders of **Neutral PLC**. (05 marks)

Question 02

“**anything.lk**” is a website which belongs to **Anything (Pvt) Ltd.** (“the company”). Sellers can post their adds by paying a fee and buyers can visit the website and buy the required products by contacting the sellers. You joined as an Accountant of this company recently.

Since the company is an IT based company, there are risks attached to Information Technology.

You are required to:

Explain two(02) risk management tools in information technology that the company can use in its risks management process. (05 marks)

Question 03

The COSO internal control system framework identifies “Reliability of Financial Reporting” as one of the three objectives of an internal control system.

You are required to:

- (a) **Explain** the objective of “Reliability of Financial Reporting” as per the COSO internal control system framework. (03 marks)
- (b) **State** two(02) components of the Internal Control System. (02 marks)
- (Total 05 marks)

Question 04

AJP & Co. is an audit firm and is in the process of preparing a document guiding the engagement partners and managers in supervising and reviewing the audit files relating to audit of the financial statements in order to achieve the quality control requirements of the firm.

You are required to:

Explain three(03) matters to be included in the above guideline relating to “Supervision” of individual audit engagements. (05 marks)

_____ *End of Section A* _____

SECTION B

(Total 30 marks)

Question 05

You have applied for the “Internal Auditor” job vacancy which was posted in **PQ Ltd.’s** web site. Job vacancy described the following as the responsibilities of the job:

“Design, Implementation and maintenance of internal controls.”

The company is a supermarket chain, with 11 supermarket branches located in Western Province. As the Internal Auditor, you will be based in Head Office, Colombo.

At the interview, after a brief explanation of the company, the Chairman of the company asked whether you can implement the control activities.

Thereafter, he asked whether you can work as the auditor of the company to eliminate the risk of frauds and errors by implementing controls.

You are required to:

- (a) **Explain** two(02) “Control Activities” with an example for each. (05 marks)
- (b) **Discuss** whether the auditor can eliminate the risk of frauds and errors by implementing controls. (05 marks)
- (Total 10 marks)

Question 06

Suraj Ltd. is a company engaged in manufacturing garments to local market. It employs more than 100 employees in factory and there are 5 employees (Accountant, 2 Accounts Executives, 1 Accounts Assistant and Cashier) in finance department. All the payments are handled by the Accounts Assistant and she maintains the petty cash float also. Daily collection of the company is banked by the cashier at the end of the day after keeping Rs.10,000/- for day to day expenses per day.

Overtime is calculated by an Accounts Executive in finance department and it is banked to individual employee's bank account. It was calculated based on attendance sheets sent by the Factory Manager of **Suraj Ltd.**

Debtors' statements are prepared by exporting individual debtors' ledger details to an Excel Sheet. There are frequent disputes in settlements due to missing or duplicated sales invoice details. An Accounts Executive is authorized to access the debtors' ledger and prepare the Debtors' Statements. When he is busy, the Accounts Assistant prepares the Debtors' Statements.

A new inventory management system has been introduced during the year but there are significant differences between physical inventory balances and inventory records in the system since the staff are not fully aware how the system works. Further, the set of inventory data has been deleted from the master file.

You are required to:

- (a) **Identify** three(03) internal control weaknesses of **Suraj Ltd.** (03 marks)
 - (b) **State** a recommendation each to overcome weaknesses identified in (a) above. (03 marks)
 - (c) **Identify** two(02) general controls with an example for each that could be established by the management of **Suraj Ltd.** to strengthen the information systems of the company. (04 marks)
- (Total 10 marks)

Question 07

- (a) **XYZ Ltd.** is considering to change the existing auditor and is planning to appoint **RK Associates** as the statutory auditor of **XYZ Ltd.** for the year ended 31st March 2024.

You are required to:

Explain two(02) procedures that **RK Associates** should perform before accepting the appointment as the statutory auditor of **XYZ Ltd.** (04 marks)

- (b) **Perera, Silva** and **Cooray** are the partners of **PSC Associates**, a firm of Chartered Accountants. Consider the following matters relating to **PSC Associates**:
 - (1) The spouse of **Perera** has joined an audit client of **PSC Associates** as the Finance Controller.
 - (2) **Silva** has invested in an unit trust audited by **PSC Associates**.
 - (3) **PSC Associates** has obtained a large sum (Rs.10 million) as a loan to purchase a sophisticated audit system, from a bank audited by **PSC Associates**.

You are required to:

Explain how each of the above situations to be considered by **PSC Associates**. (06 marks)

(Total 10 marks)

SECTION C

(Total 50 marks)

Question 08

Sunflower PLC (SPLC) is engaged in the business of selling tiles. **ABC & Co.**, a firm of Chartered Accountants has been the auditor of **SPLC** since 2019 and the audit of financial statements for the year ended 31st March 2024 is in progress. After the year end and before starting the audit, **Rose PLC** has acquired **SPLC**.

Audit partner has been changed according to the partner rotation policy of the firm. During the initial meeting with the new Executive Chairman of **SPLC**, he mentioned that **SPLC** has implemented a new inventory system and expect the auditor to verify the inventory control system in the new system when the auditor performs the audit procedures.

The auditor has determined the materiality level based on profit before tax which amounts to Rs.1,250,000/-.

The audit team has identified the following misstatements during the audit:

- (1) There is a difference of Rs.997,000/- between the inventory report generated by the system and the physical count report. Value shown in the system report is higher than physical stock report. Inventory value in the system has been linked to the financial statements.
- (2) Sample testing of sales invoices revealed exceptions in 7 invoices amounting to Rs.334,000/-.
- (3) Incorrect application of depreciation rate has been detected and the impact has been valued. Of which, Rs.367,000/- relates to previous years and Rs.24,000/- relates to current year. The management agreed to make necessary adjustments and to disclose in the financial statements.
- (4) Audit Manager has not prepared an engagement letter for this audit considering it as a recurring audit, even though the engagement partner has been changed. However, new audit partner is in the view that it is necessary to send an engagement letter even for a recurring audit due to the change of the partner.

You are required to:

- (a) **Explain** three(03) elements of an assurance engagement. (06 marks)
- (b) **State** four(04) conditions that the terms of the engagement letter can be revised. (04 marks)
- (c) **Identify** five(05) matters to be included in the list of matters to be inquired from the management of **SPLC**. (05 marks)
- (d) **State** four(04) reasons why assessment of materiality is important for an audit. (04 marks)
- (e) **Explain** how to evaluate the above misstatements identified during the audit, before communications with Those Charged with Governance (TCWG). (06 marks)

(Total 25 marks)

Question 09

New World PLC (NW) owns and operates a luxury shopping mall situated in Colombo 02. The audit for the year ended 31st March 2024 is in progress. A large sum of a bank loan has been obtained by the company for the construction of the mall by mortgaging the land and the mall constructed.

Due to the economic condition in the country, **NW** has incurred operating losses during the year and previous year. As a result, six (06) loan installments of **NW** are in arrears. During the audit, loan verification has been assigned to **Ranga**, who is a junior team member of the audit team. Correspondence with the bank shows that **NW** has violated loan covenants and the bank has sent a letter of demand as the first step of the legal action to recover the loan by acquiring land and the building. Loan covenants required **NW** to maintain certain financial ratios including debt to equity ratio. However, the management has not taken any action in this regard, and this has not been communicated to the auditor. **Ranga** has requested **NW** to call for direct confirmation of the balance outstanding of the loan. Other than this, **Ranga** did not follow any other audit procedures to obtain audit evidence for this.

Materiality level of Rs.3,456,000/- has been decided based on profit before tax (PBT). **NW** has imported a high-tech generator during the year to provide power during the power cuts. Rs.5 million has been capitalized as a special fee paid to get permission to import a generator due to the current import restrictions. However, **NW** is unable to provide supporting documents to justify this amount that can be capitalized as an asset, except for the cheque payment appearing in the bank statement. Therefore, the auditor suggested that this amount should be considered as an expense. However, **NW** did not agree with the adjustment and agreed to provide management representation that the special fee is a capital expenditure.

During the physical verification of Property, Plant and Equipment it was observed that five (5) air conditioning machines were not physically available. Security officer of the premises has orally confirmed that the machines were taken for regular service by the third party who has contracted for maintenance. Further, two key management persons resigned recently from the company and those positions have not been filled yet.

You are required to:

- (a) **Assess** the reliability of following audit evidences stated in the above scenario:
- Receiving a direct confirmation of the loan from the bank.
 - Obtaining management representation as the audit evidence for considering the special fee as a capital expenditure.
 - Oral confirmation of the security officer. (06 marks)
- (b) **Discuss** the appropriateness of the loan confirmation procedure in gathering audit evidences on borrowings. (04 marks)
- (c) **Assess** the impact of the 'special fee' on the audit opinion. (06 marks)
- (d) **Explain** two(02) circumstances where the auditor may consider to include the emphasis of matter paragraph in the auditor's report. (04 marks)
- (e) **Identify** five(05) events and conditions that may cast doubt about the going concern of **NW**. (05 marks)

(Total 25 marks)

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.