

ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

LEVEL III EXAMINATION - JANUARY 2025

(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.**

01-02-2025

Afternoon

[01.45 - 05.00]

No. of Pages : 07

No. of Questions : 09

SECTION A

(Total 20 marks)

Question 01

Sewana Homes (Pvt) Ltd. is engaged in construction and selling small scale residential apartments in Sri Lanka. Last two financial years were an extremely difficult period for the company. However, during the current year, the company was able to sell few housing units that were completed almost three years before.

You are required to:

Explain three(03) economic factors that may have negatively impacted **Sewana Homes (Pvt) Ltd.** (05 marks)

Question 02

Coco PLC has coconut estates and is engaged in producing premium quality coconut oil. Desiccated coconuts are also purchased when the production from own estates is not adequate.

Recently, a SLS quality certification audit was conducted and it was revealed that desiccated coconut stock purchased in last month contained a toxic fungus and as a result, oil stock in hand and issued to the market also had the impact from this toxic fungus. This is bound to inform the Consumer Protection Authority and Public Health Authority about the poor quality oil production due to violation of food safety regulations and it is highly likely that this news will spread in media as the staff is aware of the issue.

You are required to:

Explain two(02) internal risks indicated in the above scenario. (05 marks)

Question 03

When performing an audit engagement, the auditor obtains audit evidences through various types of audit procedures.

You are required to:

Explain two(02) types of audit procedures to obtain audit evidences that can be performed by the auditor with an example for each type of audit procedure. (05 marks)

Question 04

Susantha has a professional qualification and he established an audit firm, **S & A Associates** with his practicing certificate. This audit firm has been appointed as the external auditor of few clients during the year 2024. **Susantha** communicated the staff about the importance of establishing quality controls in the firm and the importance of maintaining quality standards in performing the engagements.

You are required to:

- (a) **Identify** two(02) elements of a system of quality control. (02 marks)
- (b) **State** three(03) matters to be addressed by the audit firm for consistency in the quality of engagement performance. (03 marks)

(Total 05 marks)

End of Section A

SECTION B

(Total 30 marks)

Question 05

You are the audit supervisor of the external Audit of **ABC Construction (Pvt) Ltd. (ABC)**.

You have observed that the following balances were included in the draft Statement of Financial Position of **ABC** as at 31st March 2024 at the time of preparing the Audit Plan.

As at 31st March 2024

	Rs.
Property, Plant and Equipment at Carrying Value	4,190,360
Current Assets	11,102,170
Total Assets	15,292,530
Stated Capital	2,000,000
Accumulated Losses as at 01 st April 2023	(7,122,460)
Loss for the Year	(1,125,400)
Current Liabilities	21,540,390
Total Equity and Liabilities	15,292,530

Current Assets of **ABC** include a Rs. 10 million loan provided to **BCC Construction (Pvt) Ltd. (BCC)**, whose directors and shareholders are the same as those of **ABC**.

ABC has been reporting operational losses during the last three years due to downfall in construction industry.

The directors of **ABC** have informed your engagement partner that, **ABC** will expect to generate a massive profit for the financial year ended 31st March 2025, as they have signed a contract for a major project valued over Rs. 300 million.

You are required to:

- (a) **Explain** two(02) conditions / events that may cast doubt about the going concern assumption used by **ABC Construction (Pvt) Ltd.** (04 marks)
 - (b) **State** three(03) audit procedures that you need to perform in auditing the loan given to **BCC.** (03 marks)
 - (c) **Identify** three(03) circumstances in which there is a risk that the auditor may not detect undisclosed related party transactions. (03 marks)
- (Total 10 marks)

Question 06

Travelex Ltd. is engaged in travel agency business by arranging foreign tours and selling air tickets.

Tissera Kuruppu is the sole practitioner of **Tissera Associates** an audit firm and **Sachin** who is a qualified Chartered Accountant of this firm, works as the audit manager of the statutory audit of **Travelex Ltd.** for the year ended 31st March 2024. The statutory audit is in progress. The management has offered a tour to India to **Tissera** and **Sachin**, as a gift because **Sachin** helped the accountant to prepare the income tax provision and deferred tax provision of the company for the year ended 31st March 2024. **Sachin's** purpose was to promote the new tax business lines of the audit firm. **Sachin** briefly told the accountant of **Travelex Ltd.** about the new tax services during the lunch when they met for lunch.

You are required to:

- (a) **Discuss** two(02) threats to compliance with fundamental principles of ethics with reference to the above facts. (06 marks)
 - (b) **State** four(04) steps to be implemented in **Tissera Associates** to reduce / eliminate the above-mentioned threats. (04 marks)
- (Total 10 marks)

Question 07

Jayarathna Hardware (Pvt) Ltd. (*the Company*) is engaged in importing hardware items and selling through local agents. The prices of most of these hardware had been increased rapidly during the last 2 years with the adverse economic conditions of the country. With the expectation of further increase in prices, as instructed by the Managing Director of the Company additional hardware items amounting to Rs. 125 million were imported through an import loan obtained from a financial institution to be settled in one year.

However, the demand for these hardware items further reduced and the company requested the bank to reschedule the loan into a five-year bank loan. Further, the local prices of these items declined.

As at 31 March 2024, the draft Statement of Financial Position of the company reflected Rs.74,125,300/- worth of these hardware items at cost as inventory. However, Net Realizable Value (NRV) of these items was assessed as Rs.41,260,415/-. The company's draft financial statements show a profit of Rs.8,560,210/-.

The Managing Director does not agree to change the figures in the draft Financial Statements assuming that it will affect the reported performance and in turn affects the future banking facilities.

You are the external auditor of the company and determined materiality level based on profit before tax which amounts to Rs. 1.2 million.

You are required to:

- (a) **Assess** the impact of the matters described in the above scenario to the audit opinion of Auditor's Report on the Financial Statements of **Jayarathna Hardware (Pvt) Ltd.** for the year ended 31st March 2024. (06 marks)
- (b) **State** four(04) key elements of the Auditor's Report. (04 marks)
- (Total 10 marks)

End of Section B

SECTION C

(Total 50 marks)

Question 08

Taste (Pvt) Ltd. (*the Company*) is engaged in manufacturing of coconut powder for the local market. Now the company provides its products to 10 super markets and 100 agents. More than 100 employees are working in the company.

Last month, one super market returned all coconut powder products purchased due to low quality. An investigation was carried out and it was found that the sample of products was not checked by a qualified quality assurance person and it was checked by the store keeper.

The Board of Directors requested the internal audit team to review the internal control system of **Taste (Pvt) Ltd.** for their operating effectiveness and submit a report.

The following were identified by the internal audit team:

- Inventory management system includes only inventory quantities therefore, items cannot be reconciled with the general ledger.
- Inventory valuations are maintained manually.
- Internal audit team carried out a physical verification of full inventory as a regular practice. It was discovered that a large quantity of expired stock powder included in inventory of the company.
- Though there are registered suppliers, some materials have been purchased from an unregistered supplier and sample was not checked before issuing to the production.
- When payments are made on suppliers, some purchase orders did not agree with the invoices.

IT systems:

The Company uses a number of IT systems for different functions such as fixed assets register, invoicing, payroll, etc. These are not integrated to the General Ledger system. Batch entries posted to General Ledger by the Accounts Executive at the end of each day. The all staff of Finance Division can access to all systems and databases using a single user's account to maintain the records.

You are required to:

- (a) **Identify** four(04) key business processes of **Taste (Pvt) Ltd.** (04 marks)
- (b) (i) **Identify** four(04) internal control weaknesses of **Taste (Pvt) Ltd.** (04 marks)
(ii) **State** a recommendation each to overcome the above weaknesses identified in (b) (i) above. (04 marks)
- (c) **Explain** three(03) control activities that can be implemented by **Taste (Pvt) Ltd.**(06 marks)
- (d) **State** four(04) examples for general controls that can be used for prevention or detection of unauthorised changes to program of **Taste (Pvt) Ltd.** (04 marks)
- (e) **State** three(03) signs that may result in deficiencies in any internal control system in general. (03 marks)
- (Total 25 marks)

Question 09

Malcom PLC (*the Company*) is the sole agent for the Japanese tyre brand '**Rodex**'. **Apex NW** has been appointed as the auditor of the company for this year and this is the 1st year of **Apex NW** being the auditor of **Malcom PLC**. This entity is considered as high risk as it is a public listed company and **Apex NW's** first year of audit of this company.

Sales and debtors:

The auditor checked the sales invoices of top 10 corporate customers recorded in the debtors' account for **Malcom PLC** and called for direct confirmations from same debtors. Two (02) debtors with total outstanding amounts of Rs.6,450,000/- and Rs.7,900,000/- respectively as at 31st March 2024 have confirmed that they do not owe any balance to **Malcom PLC**.

Corporate customers are directly managed by the Director of Marketing (DM), who is entitled to receive a sales commission. The management, including the CEO, has confirmed that sales have occurred, backed by all relevant documentation, which justifies the existence of the debtors' balance. As a policy of the company, if the balance is not recovered within a year, a full provision will be made in the next year. During the reconciliation process, the auditor found that the settlement of some sales invoices by debtors were recorded as sales rather than as debtors' settlements, and the invoices were duplicated in the sales ledger. This was informed to the CEO. Additional samples were tested to mitigate the risk, and no further issues were found.

Summary of unaudited financial figures as at 31 March 2024 are as follows:

	Rs.'000
Turnover	1,855,000
Profit Before Tax	326,000
Total Assets	2,769,000
Net Assets	1,055,000

Other matters identified by the auditor:

- The bank loan interest expense for last month that has not been accrued, was Rs.2,050,000/-.
- Interest income over-stated by Rs.313,000/-.
- The following related party transaction has not been disclosed in the financial statements:
 - Sales made to a related party – Rs.200,000/-.

Auditor considers incorrect recording of receipts from debtor as sales, as a fraud risk indicator that a fraud may exist that may involve management.

You are required to:

- (a) **Identify** five(05) areas that need special attention in performing the audit procedures of **Malcom PLC**. (05 marks)
- (b) **Explain** how a reasonable assurance engagement is differentiated from a limited assurance engagement. (04 marks)
- (c) **State** four(04) reasons why planning is important for the audit of **Malcom PLC**. (04 marks)
- (d) (i) **Explain** what is meant by Fraudulent Financial Reporting. (02 marks)
(ii) **Explain** the responsibility of the management of **Malcom PLC** regarding the prevention and detection of frauds. (04 marks)
- (e) **Explain** three(03) matters to be communicated to Management and Those Charged with Governance of **Malcom PLC**. (06 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.