



Association of Accounting Technicians of Sri Lanka

July 2017 Examination - AA3 Level

**Questions and Suggested Answers
(AA34)**

**PROCESSES, CONTROLS AND AUDIT
(PCA)**

Association of Accounting Technicians of Sri Lanka
No. 540, Ven. Muruththettuve Ananda Nahimi Mawatha,
Narahenpita, Colombo 05.

Tel : 011-2-559 669

A publication of the Education and Training Division

THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA
EDUCATION AND TRAINING DIVISION

AA3 Examination - July 2017
(AA34) Processes, Controls and Audit

SUGGESTED ANSWERS

SECTION – A

Four (04) compulsory questions
(20 Marks)

Suggested Answers to Question One:

- (A) (a) The most likely objective for a startup business is simply **survival**.
(b) After his business becomes more established, his most likely business objective would be not only to survive but also to **continue earning profits, growth in profits and cash flows, business growth and increase in market share**.

(02 marks)

- (B) I. Level of Education of communities
II. Increase in elderly population
III. Religions background
IV. Life style
V. Values, beliefs and behaviours of consumers, households and communities. *(03 marks)*

(Total 05 marks)

Suggested Answers to Question Two:

- (A) I. Risk avoidance
II. Risk acceptance
III. Risk Transfer
IV. Risk reduction *(02 marks)*

- (B) I. Diversification of operation
II. Risk sharing
III. Business contingency planning
IV. Internal control for operational Risks. *(03 marks)*

(Total 05 marks)

Suggested Answers to Question Three:

(A) Professional skepticism is an attitude that includes a **questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud**. This requires auditor to be alert to, audit evidence, information and conditions that may indicate possible frauds.

(02 marks)

- (B) (i). Materiality & Audit Risk.
(ii). Nature, Timing and extent of audit procedures
(iii). Drawing conclusion based on the audit evidence obtained.
(iv). Evaluation of whether sufficient appropriate audit evidence has been obtained.

(03 marks)

(Total 05 marks)

Suggested Answers to Question Four:

- (A) (i). To provide it with reasonable assurance that the firm and its personnel comply with professional standards and applicable legal and regulatory requirement.
(ii). To ensure that the report is issued report issued by the firm or engagement partners are appropriate in the circumstances.

(02 marks)

- (B) (i). The work has been performed in accordance with the audit program.
(ii). The work performed and the results obtained have been adequately documented.
(iii). All significant matters have been resolved or are reflected in audit conclusions.
(iv). The objectives of the audit procedures have been achieved.
(v). The conclusions expressed are consistent with the result of the work performed and support the audit opinion fundamentals.

(03 marks)

(Total 05 marks)

End of Section A

**Three (03) compulsory questions
(30 Marks)**

Suggested Answers to Question Five:

(A) An **Assurance Engagement** is an engagement in which a **practitioner** express an opinion or conclusion designed to enhance the degree of confidence of the **intended users** other than the **responsible party** about the outcome of the evaluation of a **subject matter** against **certain criteria**. (Underlined words are vital in the explanation.)

(04 marks)

- (B) (i). Financial Audit (31 March 2017) = This is an annual external audit so this type of engagement can be considered as a **reasonable assurance engagement**.
- (ii). Financial Audit on 5 years' financial forecast = This is a **limited assurance** engagement because The Assurance practitioner has been asked to report on financial forecast that has been prepared by Swarna Ceramic (Pvt)Ltd.
- (iii). Non – Financial Information – (Key performance indicators) = assurance on key Performance indicators reported by Swarna Ceramic (Pvt) Ltd about non – financial aspects Of performance, is a **limited assurance** engagement.

(06 marks)

(Total 10 marks)

Suggested Answers to Question six:

- A. Following practices are important when the engagement team of AB (Pvt) Ltd consider about gathering audit evidence
- i. Audit evidence is more reliable when it is obtained from **independent sources** outside the entity.
 - ii. **Audit evidence generated internally** are more reliable when the related controls imposed by the entity are effective

-
- iii. **Audit evidence obtained directly** by the Auditor is more reliable.
 - iv. **Documentary evidence** is more reliable, whether paper, electronic or other medium
 - v. **Original documents** are more reliable than photocopy or faxes.

(04 marks)

B.

- i. Inquiry : this includes obtaining response, formally or informally, from the Management of AB (Pvt) Ltd and the particular leasing company
- ii. Inspection : inspection of lease agreement to confirm the terms and Repayment details and check the bank statements regarding payments made for the year.
- iii. Recalculation : Recalculation of interest payment and the installment to check the accuracy
- iv. External confirmation : obtaining the direct written confirmation from the Leasing company

(06 marks)

(10 marks)

Suggested Answers to Question seven:

- A. Management is responsible for the identification of related party transactions. such transactions should be properly approved as they are frequently not at arm's length. Management is also responsible for the disclosure of related party transactions.

(03 marks)

- B.
- 1. Enquire of management and the directors as to whether transactions have taken place with related parties that are required to be disclosed in the financial statements.
 - 2. Review prior year working papers for names of known related parties.
 - 3. Review minutes of meetings of shareholders and directors and other relevant statutory records such as register of directors' interests.
 - 4. Review accounting records for large or unusual transactions or balances, in particular transactions recognized at, or near, the end of the financial period.
 - 5. Review confirmations of loan receivables and payable and confirmation from banks, such a review may indicate the relationship, is any, of guarantees to the entity.
 - 6. Review investment transactions, for example purchase or sale of an interest in a joint venture or other entity.

-
7. Enquire as to the names of all pension and other trusts established for the benefit of employees and the names of their management and trustees.
 8. Enquire as at to the affiliation of directors and officers with other entities.
 9. Review the register of interests in shares to determine the names of principal shareholders.
 10. Enquire of other auditors currently involved in the group's audit as to their knowledge of additional related parties (Eg. Group Engagement Team).
 11. Review the entity's tax returns, returns made under statute and other information supplied to regulatory agencies for evidence of the existence of related parties.
 12. Review invoices and correspondence from lawyers for indications of the existence of related parties or related party transactions.

(05 marks)

C. All related party transaction should be disclosed in the financial statements of **Green (Pvt) Ltd.**
In written representation it should be noted as follows

“Except as disclosed, no transactions have been entered into by the company with any Director, Officer or employee or with any party in which any director, officer or employee of the company has any material direct or indirect interest”

In other words;

They have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirements of Sri Lanka Accounting Standard LKAS 24 Related Party Disclosures.

(02 marks)

(Total 10 marks)

End of Section B

Two (02) compulsory questions
(Total 50 marks)

Suggested Answers to Question Eight:

(A) (a).

1. Date
2. Job No.
3. Cost centre
4. Details of items
5. Required Quantity
6. Issued Quantity
7. Stock-keeper's signature
8. Value of the item
9. Approved person's signature
10. Requested person's signature

(03 marks)

(b).

- i. Select a production order (or a sample) and trace to its corresponding customer order.
- ii. Select a sample of material requisition notes and trace those to the respective production orders.
- iii. Trace a sample of material requisition notes to the respective corresponding material issue notes.
- iv. Select goods dispatch notes and trace the details (Eg. quantity, customer's details etc...) to relevant customer's order, goods dispatch note and sales invoice.
- v. Select a sample of goods dispatch reports and check whether the sales department has noted any exceptions, if no exceptions have been noted, agree the same sample of goods dispatches checked by sales department to supporting documents to verify whether we get the same results. However, if exceptions have been noted, investigate the follow up actions of the sales department and conclusion reached thereof.

(05 marks)

- (c).
- i. Inquires of management, appropriate individuals within the internal audit function and others within the entity.
 - ii. Conduct an analytical procedure
 - iii. Observation & inspection of the entity
 - iv. Information from other engagements under taken for the entity.
 - v. Client acceptance or continuance process.
 - vi. Checking last year working file.
 - vii. Review information obtained from external sources.
 - viii. Review of financial publications of the company.

(03 marks)

- (d).
1. **Completeness** - all amounts chargeable to customers for goods that should have been recorded in the books of Taste Ltd.
 2. **Accuracy** - Sales transactions have been accurately determined, summarized and recorded in the financial statements.
 3. **Occurrence** - Recorded sales transactions represent amounts derived from the sale of goods of Taste Ltd.
 4. **Cut-off** - Sales have been recorded in the correct period.
 5. **Classification** - Sales have been recorded in the correct amounts and have been properly classified, described and disclosed in the financial statements.

(B)

	ITGS Control	Examples
a	Development of computer application	<ol style="list-style-type: none"> 1. Standards over system design, programming and documentation. 2. Approval by computer users and management 3. Segregation of duties so that those responsible for design are not responsible for testing 4. Training of staff in new procedures and availability of adequate documentation.
b	Controls of prevent unauthorized amendments to data files	<ol style="list-style-type: none"> 1. Physical security over remote terminals. 2. Limited access to authorized personnel only. 3. Firewalls. 4. User identification controls such as passwords. 5. Encryption of data.

c	Controls to secure continuity of operations	<ol style="list-style-type: none"> 1. Storing extra copies of programs and data files off-site. 2. Protection of equipment against fire and other hazards. 3. Back-up power sources. 4. Disaster recovery procedures - availability of back-up facilities. 5. Maintenance agreements and insurance.
d	Prevention or detection of unauthorized changes to programme	<ol style="list-style-type: none"> 1. Segregation of duties. 2. Password protection of programs. 3. Restricted accesses to central computer by locked doors, key pads. 4. Virus checks on software. 5. Backup copies of programs being taken and stored in other locations.

(25 marks)

Suggested Answers to Question Nine:

(A)

a)

1. Physical verification of a sample of assets.
2. Obtain previous year's audited statement of financial position and check whether opening balances are correctly brought forward.
3. Check minutes of the Board of Directors' meeting whether acquisition or disposals are properly approved.
4. Check the supplier's invoices to verify cost of assets.
5. Check the document to verify ownership. Eg. Land - Title deed.
6. Check whether all the Property, Plant and Equipment have been revalued.

(03 marks)

- b) Test of controls are conducted **to evaluate the operating effectiveness of controls** in preventing, detecting and correcting material misstatement at the assertion level. Which focused on internal control & control procedures.
- But, substantive procedure are conducted to **detect material misstatement at the assertion level**. Which focused on each material class of transactions, account balance and disclosure.

(03 marks)

(B)

a)

1. In accordance with LKAS 16 Property, Plant and Equipment, the cost of an item of PPE shall be recognized as an asset, if and only if, it is probable that future economic benefits associated with the item will flow to the entity, and cost of the item can be measured reliably. Under this recognition principle, the entity shall not recognize the costs of renovations, as such costs represent repairs and maintenance - nature of expenditure incurred to maintain the existing level of future economic benefits expected from buildings.
2. Accordingly, Rs. 2,500,000/- should not be capitalized but expensed to profit as incurred. Effect on depreciation is assumed to be immaterial as amounts have been capitalized close to year end.
3. As the amount is material and management most likely is not willing to adjust the books of accounts, the balance of Buildings and PPE thereof as per the Financial Statements has been materially misstated.
4. As we could conclude that, based on evidence obtained, the financial statements as a whole are not free from material misstatement, a Modified Opinion is required. Although misstatement is material, it can be concluded that it is not pervasive to the financial statements. Therefore a Qualified Opinion is required.

(06 marks)

b)

- i). Title
- ii). Addressee
- iii). Introductory paragraph
- iv). Management responsibility for the financial statement
- v). Auditor's responsibility
- vi). Other reporting responsibility
- vii). signature of the auditor
- viii). date of the audit report
- ix). Auditor's address

(03 marks)

(C)

a) i) **self – Interest Threat:**

Auditor has been given the opportunity to setup a branch office of his audit firm at the showroom building of the client and the managing director has agreed with the auditor a monthly rental which is extremely low amount compared to the market rates in the area. This will create a self- Interest Threat to the auditor.

(04 marks)

ii) **Familiarity Threat:**

The senior person of the audit firm has been handling the audit of Shiran Garment (pvt) Ltd for last 12 years.so there is a threat to be too sympathetic to clients interests or too accepting client's work due to a long or close relationship with the client. This will create a familiarity threat to the auditor

iii) **Intimidation:**

The threat and professional accountant will be deterred from acting objectively because of actual or perceived pressures. Since professional Accountant has setup his firm in client premises, it may cause for under pressure situation.

(04 marks)

b) i) **Objectivity:**

The principle of objectivity impose the obligation on all members to be fair minded intellectually honest and free from conflict of interest.

ii) **Professional competence:**

Members should refrain from undertaking or continuing assignments which they are not professional competent to carry out, unless competent advice and assistance is obtained to enable them satisfactorily carry out the assignment. Professional competence may be divided into two separate phases,

- i) Attainment of professional competence
- ii) Maintenance of professional competence

iii) **Professional Behavior:**

This principle imposes an obligation on all members to comply with relevant laws and regulations and avoid any action that the member knows or should know may discredit the profession.

(06 marks)

(Total 25 marks)

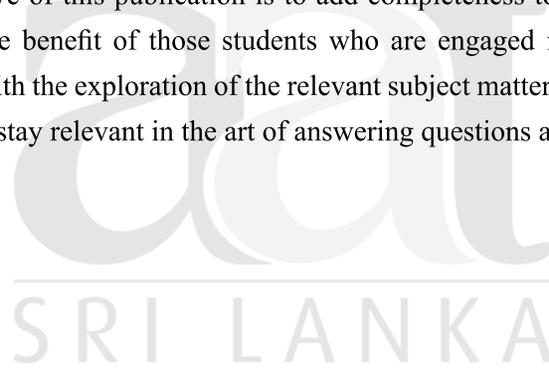
End of Section C

Notice :

These answers compiled and issued by the Education and Training Division of AAT Sri Lanka constitute part and parcel of study material for AAT students.

These should be understood as Suggested Answers to question set at AAT Examinations and should not be construed as the “Only” answers, or, for that matter even as “Model Answers”.

The fundamental objective of this publication is to add completeness to its series of study texts, designs especially for the benefit of those students who are engaged in self-studies. These are intended to assist them with the exploration of the relevant subject matter and further enhance their understanding as well as stay relevant in the art of answering questions at examination level.



© 2017 by the Association of Accounting Technicians of Sri Lanka (AAT Sri Lanka)

All rights reserved. No part of this document may be reproduced or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without prior written permission of the Association of Accounting Technicians of Sri Lanka (AAT Sri Lanka)