



Association of Accounting Technicians of Sri Lanka

July 2019 Examination - AA3 Level

**Questions and Suggested Answers
(AA34)**

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

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THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

AA3 Examination-July 2019

(AA34) Processes, Controls and Audit

SUGGESTED ANSWERS

Four (04) compulsory questions
(Total 20 Marks)

SECTION - A

Suggested Answers to Question 01:

Chapter 01- Business Environment

Economic Factors	Legal Factors
1. Inflation in the country	1. Consumer Law
2. Fluctuations in foreign exchange rates	2. Labour Law
3. Interest rates	3. Environmental Law
4. Taxation	4. Health and Safety Law
5. Government spending	5. Accounting and Auditing Standards Act
6. Demand and supply factors	6. EPF Act
7. Unemployment	7. ETF Act
8. Global economic factors	

(05 marks)

Suggested Answers to Question 02:

Chapter 02- Governance, Risk and Compliance

(a) *Risk Acceptance*

1. The potential impact of the risk is low
2. The likelihood of an adverse risk is low
3. The residual risk is within the organization's risk tolerance and so acceptable.

(02 marks)

(b) *Mitigating methods used*

1. Risk Avoidance
2. Risk Acceptance
3. Risk Reduction
4. Risk Transfer

(03 marks)

(Total 05 marks)

Suggested Answers to Question 03:

(a)

Chapter 05 - Audit Process

1. Nature of the entity including owners of the organization, organizational structure financing methods , business operations , financial reporting framework used by the management etc.
2. Industry , regulatory and other external factors
3. The entity's Internal control system
4. The objectives, strategies and related business risks such as new products or services , new investments , proposed mergers etc.
5. Selection and Application of Accounting Policies applied by the management , whether the changes of those policies if any have reasonable justifications
6. Measurement and review of the entity's financial performance

(03 marks)

(b)

Chapter 03- Business Processes and Internal Controls

Components of internal controls

1. Control environment
2. Risk assessment process
3. Control Activities
4. Information and communication
5. Monitoring of controls

(02marks)

(Total 05 marks)

Suggested Answers to Question 04:

Chapter 10- Audit Quality

(a) Elements of system of Quality Control not managed at NZ Associates

1. Leadership responsibilities for quality within the firm
2. Human resources
3. Engagement performance
4. Monitoring
5. Acceptance and continuance of client relationships
6. Ethical requirements

(03 marks)

(b) Ravinath's Responsibilities for maintaining quality controls within the firm

- 1.) As the managing partner of the firm he should be responsible for the firm's system of quality.
- 2.) There is lack of staff in the firm and hence no sufficient and appropriate experience staff to carry out the job. Then he should ensure the availability of sufficient personnel with the competence and capabilities.
- 3.) Further, manager is not in the country and partner is focusing on two large audits and he should give required authority to carry out other engagements.
- 4.) Therefore, he should ensure the establishment of quality culture by implementing policies and procedures and he should inspire the quality culture within NZ.
- 5.) He can appoint an individual or group of individuals to maintain quality within NZ.

(02 marks)

(Total 05 marks)

End of Section A

Suggested Answers to Question 05:

Chapter 04- Assurance Engagements and Related Services

(a) Three-party relationship

As per the above rule the three parties are Intended Users , responsible party and practitioner.
In this engagement;

- **Intended user** – BOI – who wants to get certified the revenue from export of Sanjeev (Pvt) Ltd
- **Responsible party** – Sanjeev (Pvt) Ltd – the person responsible for the subject matter information of the assurance engagement.
- **The Practitioner** – Kamal Associates – The individual providing professional services who is reviewing the subject matter and provide the assurance.
- **Subject matter** – Certify the revenue from export

(06 marks)

(b) Requirements to be considered when accepting and managing the assurance engagements

1. Ethical and quality control requirements
2. Engagement acceptance and continuance
3. Planning and performing engagement
4. Assessing the appropriateness of the subject matter
5. Assessing the suitability of the criteria
6. Materiality and assurance engagement risk
7. Obtaining evidence
8. Documentation
9. Preparing the assurance report

(04 marks)

(Total 10 marks)

Suggested Answers to Question 06:

Chapter 05- Audit Processes

(A)

(a) Combined Approach

Combined Approach is when a Company has a sound internal control system and auditor decides controls are effective, combination of substantive procedures and test of controls can be used. Specially when it comes to complex businesses such as banks and supermarkets, substantive procedures alone cannot be used to gather sufficient audit evidences.

(02 marks)

(b) Substantive Audit Procedures to test the occurrence of revenue

1. Agree a sample of invoice dates with customer acknowledgement dates to ensure that revenue is recognized once the performance obligations are satisfied.
2. Call confirmations from a sample of customers for the sales made by the Company during the year
3. Agree the subsequent settlements made by the customer to invoices.
3. Test subsequent returns made by the customer
4. Test cut-off procedures
5. Perform subsequent analytical review procedures by customer , product and month wise
6. Check a sample of supporting documents / agree the invoice details such as item description and quantity with stores records to ensure goods issued are properly recorded

(03 marks)

(B)

(a) Audit Documentation

Audit documentation is the record of audit procedures performed, relevant audit evidence obtained and conclusions the auditor reached.

(02 marks)

(b) Information included in a working paper

1. The name of the client
2. Period end date
3. The date of work done / preparing the working paper
4. The subject , purpose or content of the working paper

5. The initials of the auditor preparing the working paper
6. The initials of the person reviewing the working paper
7. The date of review
8. The reference to the working papers on control testing and substantive testing
9. The conclusions reached for those identified issues

(03 marks)
(Total 10 marks)

Suggested Answers to Question 07

Chapter 08- Audit Reporting

(a) Unmodified Audit Opinion

The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with applicable financial reporting framework.

(03 marks)

(b) Types of Modified Opinions

1. Qualified opinion
2. An adverse opinion
3. A disclaimer of opinion

(02 marks)

(c) Impact of the issues to the audit opinion

As per LKAS 02, inventory should be valued at the lower of cost or Net Realizable Value (NRV). IT Solutions (Pvt) Ltd's inventory has overstated by Rs.4,655,000/- as the Company has not valued its inventory in accordance with LKAS 2. Accordingly, cost of sales has understated and profit for the year has been overstated by that amount. The management has not agreed to adjust the financial statements. Having obtained sufficient appropriate audit evidence, auditor concludes that misstatements, individually or in the aggregate, are material, but not pervasive to the financial statements, then needs to give a qualified audit opinion.

(05 marks)
(Total 10 marks)

End of Section B

Suggested Answers to Question 08

Chapter 03- Business Processes & Internal Controls

(A)

(a) Business Processes

1. Procurement Process
2. Payroll Process
3. Property , Plant and Equipment Management Process

(02 marks)

(b) Weaknesses in the Cash Management Processes

1. There is no segregation of duties – Bank Reconciliations are prepared by the cashier.
2. Keeping signed blank cheques with the cashier provides an opportunity for misappropriation.
3. Bank reconciliations have not been prepared for last two months.
4. Serially numbered pre-printed payment vouchers are not available
5. No approval for payments by an authorized officer.
6. There are no petty cash vouchers.
7. There is no imprest system/re-imburement process.
8. No streamlined process of banking of collections.

(04 marks)

(c) Strengths of the inventory Management

1. The stores is managed by an experienced person who is familiar with the business of the Company.
2. The delivered items are physically agreed with the inventory list provided by the supplier before raising GRNs.
3. Performing monthly stock counts in the presence of persons independent from stores activities.
4. No differences in the physical inventory counts as inventory is well recorded.
5. Issues are made only for the approved invoices.
6. All records are available in the computerized system.
7. Inventory movements are duly updated in the system.

(04 marks)

(d) Analytical procedures

1. Analytical procedures are used to evaluate financial information through analysis of possible relationships among both financial and non-financial data (Salaries and wages with number of employees)
2. To investigate the identified fluctuations and relationships that are inconsistent with related data or deviations from forecasts.
3. Analytical procedures are used to compare current year performance with last year performance
4. Analytical procedures are used as an overall review of financial information at the planning and conclusion stage of the audit as risk assessment procedure
5. Analytical review procedures can be combined with test of details

(06 marks)

(e) Even though the company has implemented sound controls over the inventory it does not mean that nothing can go wrong. Sarath needs to understand that internal control system of the organization can provide only a reasonable assurance regarding the effectiveness of achieving their intended objectives due to the inherent limitations.

Although, controls are seems to be well designed and implemented properly there are inherent limitations of internal controls are as follows.

- Continuous changes in operational risk
- Non-routine transactions may not covered through existing controls
- There can be human errors.

(05 marks)

(f) Controls should be in place to prevent or detect unauthorized changes to the programmes of the system

1. Segregation of duties (access should be provided to separate persons for each module in the system)
2. To limit the access, passwords controls needs to be implemented
3. Physical security over computer terminals
4. Virus checks on software, installing anti-virus software and implementing policies to prohibit the use of non-authorized programs or files.
5. Obtaining back-up copies of programs and kept outside the premises

(04 marks)

(Total 25 marks)

Suggested Answers to Question 09

Chapter 06- Audit Evidence

Chapter 07 - Audit Evidence – Further Consideration

(a) Audit Evidences for PPE

1. Check whether last year closing balances as per Audited Financial Statements have been properly brought forward to the current year
2. Check the details as per Fixed Asset Register agrees with Property Plant and Equipment ledger accounts
3. Board minutes relating to acquisition and disposal of assets
4. Check the title deed to verify the ownership of land
5. Check the Certificate of Registration to verify the ownership of motor vehicles
6. Check the payment vouchers to ensure the acquisition cost and accuracy of capitalized expenses.
7. Receipts relating to assets disposal
8. Check the insurance policy of the company

(04 marks)

(b) Audit Procedures in auditing the revalued Assets

1. Check the expert's professional competence including qualification and experience
2. Inquiries from the valuer/expert
3. Reviewing the valuers working papers and report with reference to revalued assets
4. Relevance , completeness and accuracy of the source data used
5. Evaluate the assumptions made by the expert .eg. Remaining life time of the assets
6. Check whether proper presentation and disclosures have been made in accordance with LKAS

(03 marks)

(c) ***Matters where written management representation is required***

1. Whether the selection and application of accounting policies are appropriate.
2. Plans or intentions that may affect the carrying value or classification of assets and liabilities
3. Liabilities , both actual and contingent
4. Title to , or control over assets liens or encumbrances on assets and assets pledged as collateral
5. Aspects of laws, rules and regulations and contractual agreements that affect the financial statements , including non-compliance
6. All deficiencies in internal control that management is aware of have been communicate to the auditor
7. Written representations about specific assertions in the financial statements
8. Significant assumptions used in making accounting estimates are reasonable
9. All subsequent events requiring adjustment or disclosure have been adjusted or disclosed
10. The effect of uncorrected misstatements are immaterial, both individually and in aggregate

(04 marks)

(d) ***Important matters to be considered when dealing with the professional valuer***

1. Determine the need for an expert
2. The relevance and reasonableness of the valuers findings
3. Professional competence , capability and objectivity of the expert/ valuer
4. Evaluating the adequacy of experts work
5. Check the agreement/terms and conditions entered with the expert
6. The findings and conclusion of the expert
7. Reference to expert in the auditor's report

(04 marks)

(B)

Chapter 04- Assurance Engagements and related services

Prior to the acceptance of the audit R&R Associates should consider the following

A&B Ltd is a new client to R&R Associates. Therefore, the firm should follow the acceptance procedure before giving a positive response to A&B (Pvt) Ltd.

- If there is any predecessor auditor / existing auditor need to inquire whether there are any professional reasons as to that R&R Associates should not accept the engagement.
- Ensure that there are no conflict of interest and possess the necessary professional competencies to act as the auditor
- Obtain background information about the company, Key Management Personnel. (Directors, top management , parent or subsidiary companies etc)

(04 marks)

(C)

Chapter 09- Ethical requirements affecting an Audit of Financial Statements

Threats to compliance with fundamental principles of ethics

1. **Self Interest Threat**-The manager of the audit team entering into employment negotiations with the audit client while being involved in the audit
2. **Familiarity Threat** -The partner is granted an offer a 5 day stay in a Villa at Maldives as the new-year gift, the value of which is significant. Accepting this from a client is considered as familiarity threat
3. **Intimidation Threat** -the chairman is inducing to accept incorrect accounting practice by threatening a fee cut.

(06 marks)

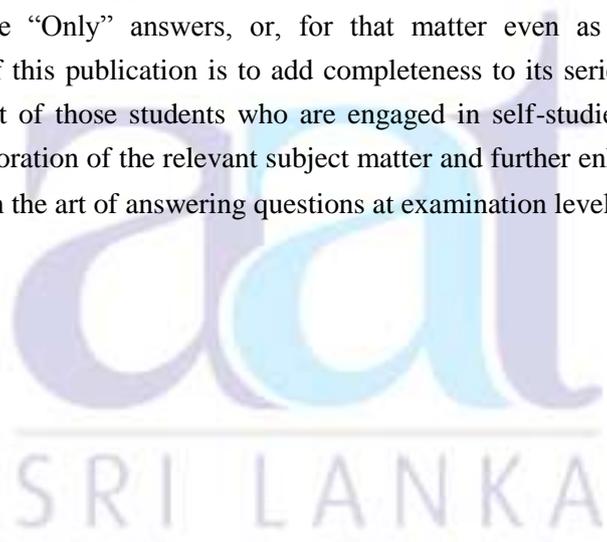
(Total 25 marks)

End of Section B

Notice:

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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.



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