



Association of Accounting Technicians of Sri Lanka

Level III Examination – July 2024

Suggested Answers

(303) FINANCIAL CONTROLS & AUDIT (FCA)

Association of Accounting Technicians of Sri Lanka

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(Total 20 Marks)

SECTION - A

Suggested Answers to Question One:

Explaining any two reasons provided below would permit full marks

1. An independent audit provides an objective examination of the financial statements, ensuring that they are free from material misstatements, whether due to error or fraud. This reduces the risk of shareholders making decisions based on faulty information and helps align the interests of management with those of the shareholders.
2. The audit provides a mechanism for shareholders to help ensure that the directors act in the company's best interests and therefore play a fundamental stewardship role.
3. The main purpose of the audit is to enhance the degree of confidence of intended users in the financial statements.
4. Audits play a crucial role in enhancing the transparency and accountability of a company's financial reporting. By verifying the accuracy and completeness of financial statements, audits ensure that shareholders have a clear and true picture of the company's financial performance and position.

(05 marks)

Suggested Answers to Question Two:

Explaining any two risk management tools mentioned below would permit full marks

1. Cyber Security

It is the body of technologies, processes, and practices designed to protect networks, computers, programs, and data from attack, damage, or unauthorized access.

2. Artificial Intelligence

It is a “cognitive technology” that extends what used to be considered human processes such as thinking, learning, and predicting, and embeds them in networked machines.

3. Basic Risk Visualization Programs

Information technology has simplified and reduced costs in risk management through tools like Microsoft Excel, PowerPoint, and SharePoint, which are widely used in organizations of all sizes for risk tracking and reporting

4. Social Media

Businesses now use social media monitoring as an IT-driven risk management tool, gaining timely insights into customer service and product quality. This immediate feedback helps address issues quickly, preventing potential reputational damage.

5. Data Integration and Analytics

Organizations often have vast databases containing risk data that can be leveraged for greater value using IT-driven tools like Electronic Data Warehouses (EDWs), Big Data, and Business Intelligence (BI) applications. These data integration and analytics tools enhance risk management by enabling faster fraud detection, real-time money laundering identification, and improved control over operational risks

6. Data Mining

Data mining serves as an IT-driven risk management tool, enabling organizations to predict machinery failures, detect fraud, and forecast company profits. By analyzing trends, classifications, patterns, and relationships from past data, predictions about future events can be made effectively

7. Open Data

Open data, which allows unrestricted access and use of certain data, serves as a valuable IT-driven risk management tool. Today, real-time data on economic conditions and markets is readily available to most organizations, aiding in informed decision-making.

(05 marks)

Suggested Answers to Question Three:

(a)

The objective of "Reliability of Financial Reporting" under the COSO internal control framework is to ensure that management prepares financial statements that are trustworthy and meet the needs of most users. These financial statements must be prepared in accordance with established standards like Generally Accepted Accounting Principles (GAAP) and Sri Lanka Accounting Standards, ensuring accuracy and fairness. While the financial statements should be reliable, they are not required to include all possible information that users might need for economic decision-making. Instead, they must present information in a way that is consistent, accurate, and compliant with legal and regulatory requirements.

(03 marks)

(b) Stating two components out of the below would permit full marks

1. Control Environment
2. Risk Assessment
3. Control Activities
4. Information & Communication
5. Monitoring



(02 marks)

(Total 05 marks)

Suggested Answers to Question Four:

- a) Tracking the progress of the engagement. Under the supervision, progress of each engagement should be supervised.
- b) Considering the competence and capabilities of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions and whether the work is being carried out by the planned
- c) Addressing significant matters arising during the engagement, considering their significance, and modifying the planned approach appropriately
- d) Identifying matters for consultation or consideration by more experienced engagement team members during the engagement

(Total 05 marks)

End of Section A

Suggested Answers to Question Five:

(a) Explaining two control activities from the below with an example would permit full marks

	Control Activity	Description	Example
1	Segregation of Duties	Duties are divided among different employees to reduce the risk of error or inappropriate actions.	<ul style="list-style-type: none"> Responsibilities for receiving cash or checks, preparing the deposit, and reconciling the deposit should be separated. In Supplier Payment process, different employees should be there to authenticate the invoice, record in the ledger and to make the payment
2	Physical Controls	Controls available to prevent / restrict unauthorized access	<ul style="list-style-type: none"> Using Access controls such as locks, security badges, biometric scanners, or surveillance cameras. Security measures such as alarms, CCTV cameras, and security personnel to monitor and protect physical assets
3	Authorization and Approval	Approval of actions before being processed.	<ul style="list-style-type: none"> Procurement Manager approves the purchase order prepared by the procurement executive before sending to the supplier. Any adjustments to product pricing, such as discounts or promotions, must be authorized by the relevant manager or another senior staff member. Refunds or voided transactions at the cash register require supervisor approval.

			<ul style="list-style-type: none"> • Shift schedules must be approved by the store manager to ensure adequate staffing levels and prevent unauthorized overtime or shift swaps that could lead to payroll discrepancies.
4	Management Controls	These controls typically involve oversight, monitoring, and enforcement of company policies, providing a framework within which employees operate.	<ul style="list-style-type: none"> • Budgetary Controls • Performance Reviews • Establishing Standard Operating Procedures (SOPs)
5	Supervision Controls	Internal controls focused on overseeing and guiding employees' activities to ensure that operations align with the supermarket's policies, procedures, and objectives.	<ul style="list-style-type: none"> • Department managers supervise the stocking and management of inventory, ensuring that products are properly shelved, expiration dates are monitored, and stock levels are maintained according to company standards. • Supervisors track employee attendance, punctuality, and adherence to assigned tasks during shifts. • Store or department managers provide daily oversight of operations, ensuring that tasks such as stocking shelves, pricing products, and maintaining store cleanliness are completed according to company standards
6	Organizational Controls	Controls are provided by organization structures, such as lines of reporting, lines of authority, authority and responsibility for managers in each position in the organization.	<ul style="list-style-type: none"> • A clear organizational hierarchy with defined roles and responsibilities for each position. There are distinct roles for store managers, department managers, cashiers, stock clerks, and

			<p>customer service representatives.</p> <ul style="list-style-type: none"> The supermarket chain develops and enforces standardized policies and procedures across all stores. These include guidelines for inventory management, customer service, employee conduct, and financial reporting
7	Arithmetical and Accounting Controls	To check the correct and accurate recording & processing of transactions	<ul style="list-style-type: none"> Reconciliations Cross checking - Verifying totals by cross-checking the sum of individual amounts with a calculated total Preparation of Trial Balance Control Accounts.
8	Personnel Controls	Attention should be given selection, training and qualifications of personnel, as well as personal qualities.	<ul style="list-style-type: none"> Ensuring capable and skilled employees are occupied in the production areas.

(05 marks)

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(b)

The auditor can never eliminate the risk of fraud and errors by implementing internal controls due to following reasons.

- The effectiveness of internal control depends on the strength of the risk awareness culture in the organization. If directors and senior management fail to provide effective leadership on risk control, the internal control system will not be as effective as it should be.
- Internal controls may reduce operational risks, but they cannot prevent operational failures and errors.
- Human errors are inevitable irrespective of the presence of internal controls.
- Controls may not be properly implemented, so that the controls are not applied in the intended way.

- Operational risks change because there are continual changes and developments in the business environment. These changes create new internal risks (as well as new external risks). Existing internal controls may not be sufficient to deal with the new risks.
- Internal controls cost money to design and implement. Sometimes the additional benefits from an internal control do not justify the cost of the control.
- Two or more employees may collude to override a control. In particular, the segregation of duties can be overridden if the performers of each duty collude.
- Management may use their authority to override the controls.

(05 marks)
(Total 10 marks)

Suggested Answers to Question Six:

	(a)	(b)
	<i>Weaknesses</i>	<i>Recommendation</i>
01	All payments are handled by the Account Assistant and maintain the petty cash float also.	Two persons should handle payments and petty cash payments. (segregation of duties)
02	All cash collection is not banked. 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.	Total daily collection should be banked at the end of the day and the petty cashier should handle all daily payments.
03	Overtime is calculated and banked to individual employee's bank account by an Account Executive without proper authorization.	Overtime calculation should be reviewed and approved by higher authorities and bank deposits should be done by another staff member.
04	Frequent disputes in settlements due to missing or duplicated sales invoice details. This shows that there are issues / loopholes in recording.	Should develop suitable app/controls to check the serial order of sales invoices.

05	The Account Assistant prepares the debtors' Statement without a proper authorization.	When the account executive is busy the other executive should be allowed to access the debtor ledger sheets and all alterations should be properly authorized.
06	Significant differences between system balance and physical balance of inventories.	The independent party should frequently check the stock balance with the physical balance.
07	A set of inventory data has been deleted from master file.	Any alteration of the inventory system should be protected by override passwords and higher-level authorities.
08	No training has been provided before implementing the inventory system	There should be a proper training on the system implementation.

(03 marks)

(c) Identifying two general control of IT out of the below would permit full marks

General Control	Example
Development of Computer Application	<ul style="list-style-type: none"> • Standard over systems design, programming and documentation • Approval by computer users and Management • Segregation of duties so that those responsible for design are not responsible for testing • Training of staff in new procedures and available of adequate documentation
Prevention or detection of unauthorized changes to programs	<ul style="list-style-type: none"> • Segregation of duties • Password protection of programs so that access is limited to computer operation staff • Restricted access to central computer by locked doors. • Virus check on software. Use of anti-virus software and policy prohibiting use of non-authorized programs or files • Back-up copies of programs being taken and stored in other locations

Testing and documentation of program changes	<ul style="list-style-type: none"> • Complete testing procedures • Documentation standards • Approval of changes by computer users and management • Training of staff using programme
Controls to prevent unauthorized amendments to data files -	<ul style="list-style-type: none"> • Physical security over remote terminals • Limited access to authorized personnel • Firewalls • User identification controls such as passwords • Encryption of Data
Controls to ensure continuity of operations	<ul style="list-style-type: none"> • Storing extra copies of programs and data files off-site • Protection of Equipment against fire and other hazards • Back-up power sources • Disaster recovery procedures • Availability of back up facilities - Maintenance agreements and insurance



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(04 marks)
(Total 10 marks)

Suggested Answers to Question Seven:

(a)

1. Ensure professionally qualified to act: Consider whether they could be disqualified
2. Ensure existing resources are adequate: Consider available time staff and technical expertise.
3. Obtain References: Make independent enquiries if directors are not personally known.
4. Communicate with present auditors: Enquire whether there are reasons / circumstances behind the change which the new auditors ought to know, also as a courtesy.
5. Determine whether acceptance would create any threats to compliance with the fundamental principles including independence.

6. Evaluate the significance of threats and apply safeguards, when necessary, to eliminate them or reduce them to an acceptable level.

(04 marks)

(b)

1. Family and personal relationship and familiarity threat

Threats to independence are created when an immediate family member of the auditor is an employee of the position to exert significant influence over the client's position. A familiarity threat is created when a member of the engagement team has a close or immediate family member who is a director or an officer of the client. Hence Perera is not independent and shall not be a part of the audit team of the relevant client.

2. Business relationship and Self-interest threat

An assurance team member has a close business relationship with an assurance client. It is a threat to the independence. Hence Silva is not independent and shall not be a part of the audit team of the relevant client.

3. Loan and guarantee and Self-interest threat

A self-interest threat would be created if the loan is not made under normal lending procedures, terms, and conditions, a self-interest threat would be created. The scenario indicates that the loan is material to the firm. Therefore, possible safeguard has to be implemented.

(06 marks)

(Total 10 marks)

End of Section B

Suggested Answers to Question Eight:**(a)**

Explaining three elements from the below would permit full marks

Elements of an assurance engagement		
1	Three party relationship	The three parties are: <ul style="list-style-type: none"> • The intended user of the information • The accountant (practitioner) • The person providing the information (the responsible party)
2	Subject Matter	This is the data to be evaluated. It has been prepared by the responsible party. It can be any form of financial or non-financial performance, process or behaviour.
3	Criteria	The subject matter is evaluated or measured against criteria to reach an opinion. These criteria will depend on the nature of the subject matter.
4	Evidence	Sufficient appropriate evidence needs to be gathered to support the required level of assurance
5	Assurance Report	The practitioner presents their conclusion or opinion in an assurance report to the intended user

(06 marks)**(b) Stating four conditions from the below would permit full marks**

The following factors may indicate that it would be appropriate to revise the terms of the engagement or remind the entity of the existing terms.

- Any indication that the entity misunderstands the objective and scope of the audit
- Any revised or special terms of the audit engagement
- A recent change in ownership or senior management
- A significant change in the nature or size of the entity's business
- A change in legal or regulatory requirements
- A change in the financial reporting framework
- A change in other reporting requirements

(04 marks)

(c) Stating five matters from the below would permit full marks

1. Management's assessment of the risk that the financial statements may be misstated due to fraud
2. Management's process for identifying and responding to the risk of fraud
3. The auditor shall communicate with the management the responsibilities of the auditor regarding the financial statement audit
4. The auditor shall communicate with the management an overview of the planned scope and timing of the audit.
5. The auditor shall communicate significant findings from the audit and other matters if any arising from the audit
6. The auditor should evaluate whether the selection and application of accounting policies are appropriate.
7. Assessment of the independence of the auditor for the SPLC and Rose PLC
8. The auditor shall communicate deficiencies identified in internal controls
9. Auditor should ensure that all subsequent events requiring adjustment or disclosure have been adjusted or disclosed,
10. Auditor should evaluate the aspects of law, regulations and contractual agreements that may affect the financial statements including non-compliance.

(05 marks)

(d) Stating four reasons from the below would permit full marks

Materiality assessment will help the auditor to

- Identify and assess the risks of material misstatement
- Determine the nature, timing, and extent of further audit procedures
- Determine the amount of audit work necessary to facilitate audit efficiency and effectiveness
- Determine the applicability of accounting standards which normally apply only to material items
- Evaluate uncorrected misstatements during the audit
- Evaluate what level of error is likely to lead to a modified opinion

(04 marks)

(e)

The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall consider the size and nature of the misstatements and the effect of uncorrected misstatements related to prior periods on relevant classes of transactions, account balances or disclosures, and the financial statement.

When we evaluate the misstatements identified during the audit,

The difference of Rs. 997,000/- between the system balance and physical balance mainly affects the company's profit. Because the system value is higher than the physical value and the system value is linked to the financial statements. Hence the company's profit has been overstated by Rs. 997,000/- But individually it is not a material misstatement.

The exception in 07 sales invoices amounting to Rs. 334,000/- is also not a material misstatement individually.

Incorrect application of depreciation rate has been accepted and has been agreed to make necessary adjustment by the management. Because of that Rs. 367,000/- related to the previous year and Rs.24,000/- related to the current year amount will charge be charged to the opening balance of the statement of Changes in Equity and current year Profit and Loss Account respectively.

The company's material level has given as Rs. 1,250,000/- and as a result of the above matters, the inventory difference and exceptions in sales invoices have been created a material impact of Rs.1,331,000/- (Rs. 997,000/- + Rs. 334,000/-) aggregately to the financial statements of SPLC

The auditor shall communicate uncorrected misstatements and the effect that they, aggregately may have on the opinion in the auditor's report with Those Charge with Governance

Therefore the auditor shall request management to correct the misstatements. Even though the management agrees to make the relevant adjustments and disclosures in the financial statements but the auditor has to perform further audit procedures to ensure appropriateness of the adjustments and disclosures made.

(06 marks)
(Total 25 marks)

Suggested Answers to Question Nine:

(a)

- **Direct Confirmation of the Loan:** The bank is an external party. The auditor has received the confirmation directly. Audit evidence is more reliable when it is obtained from outside sources outside the entity, Further evidence obtained directly by the auditor is more reliable, Hence the reliability of the confirmation of the loan is high.
- **Management's representation on Capital Expenditure:** The management prepares the representation letter. It is an internally generated document. Hence, even though it is a written and signed document the reliability of the evidence is comparatively low.
- **Oral Confirmation of the security officer:** The reliability of the oral confirmation of the security officer is comparatively low.

(06 marks)

(b)

Ranga has requested **NW** to call for direct confirmation of the outstanding balance of the loan. However, audit evidence obtained directly by the auditor is more reliable than the evidence obtained indirectly or by inference.

Accordingly, the Outstanding loan balance should be called directly by the auditor and the auditor should ask the bank to send confirmation letters only to the auditor's address. If there is no reply the auditor should follow up the process and the auditor should send additional confirmation requests.

(04 marks)

(c)

NW has imported a high-tech generator and has paid Rs. 5,000,000.00 as a special fee to get the permission to import the generator and the amount has been capitalized to the Plant. The auditor has requested relevant evidence and the management of **NW** has failed to present a valid source document other than the bank statement to justify the amount.

However, the auditor has suggested charging the amount to P/L as an expense, but the management has refused the auditor's requisition. So, it has created a disagreement with the management.

Company's Materiality level is 3,456,000.00 and as a result of that this disagreement can be considered as a material disagreement.

Based on the above factors the auditor should express a **Qualified Audit opinion**.

(06 marks)

(d)

- An uncertainty about the future outcome of exceptional litigation or regulatory action.
- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report
- Early application (where permitted) of a new accounting standard that has a material effect on the financial statements
- A major catastrophe that has had, or continuous to have, a significant effect on the entity's financial position

(04 marks)

(e)

- Six loan installments of NW are in arrears
- Pending Legal action against NW
- Adverse financial ratios
- Resignation of two management persons without any replacement
- Continuous operation loss of the company

(05 marks)

(Total 25 marks)

End of Section C

Notice:

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