



Association of Accounting Technicians of Sri Lanka

Level III Examination – July 2025

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:

Chapter 01

(a)

- Greater transparency
- Greater accountability
- Operational efficiencies
- Better risk-responding abilities
- Less likely to be mismanaged
- Better decision-making
- Promoting ethical behavior
- Increase reputation
- Positive impact on share price
- Fostering trust among employees and stakeholders.

(Expect only three advantages)

(03 marks)

(b)

1. Overseeing the preparation, presentation and adequacy of disclosures the financial statements of a Listed Entity, in accordance with Sri Lanka Accounting Standards.
2. Overseeing the Entity's compliance with financial reporting related regulations and requirements, information requirements of the Companies Act, and other relevant financial reporting-related regulations and requirements.
3. Overseeing the process to ensure that the entity's internal controls and risk management are adequate to meet the requirements of the Sri Lanka Auditing Standard.
4. Assessment of the independence and performance of the entity's external auditors.
5. To make recommendations to the board about the appointment, re-appointment, and removal of external auditors and to approve the remuneration and terms of engagement of the external auditors.

(Expect only two functions)

(02 marks)

(Total 05 marks)

Suggested Answers to Question Two:

Chapter 09

(a)

The firm shall establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements, which include:

- (a) Integrity
- (b) Objectivity
- (c) Professional competence and due care
- (d) Confidentiality
- (e) Professional behavior

(03 marks)

(b)

- Professional education
- Continuing professional development including training
- Work experience
- Coaching by more experienced staff
- Independence education for personnel who are required to be independent

(Expect only two ways)

(02 marks)

(05 marks)

Suggested Answers to Question Three:

Chapter 08 & 04

(a)

1. Independence and Conflict of Interest (Ethical Consideration)

Since the audit firm has already been serving as the external auditor of Reliance Construction (Pvt) Ltd., the parent company, there is a risk of self-review threat and conflict of interest, especially if intercompany transactions or consolidated financial statements are involved. The auditor should evaluate whether adequate safeguards (such as separate engagement teams) can be implemented to maintain objectivity and independence.

2. Competence and Resources to Perform the Audit (Practical Consideration)

The audit firm must ensure it has the necessary technical expertise and industry knowledge, especially in the solar energy sector, which may include regulatory compliance (e.g., with Sri Lanka Sustainable Energy Authority requirements) and revenue recognition from partially or largely completed solar projects.

3. Understanding business and its environment

Gain thorough understanding of client's business, industry and regulations environment.

4. Financial stability and reputation of the company.

Ensure the client's stability and reputation in the market.

5. Risk of the noncompliance of statutory requirements:

Fail to register with Sri Lanka Sustainable Energy Authority may have legal implications over the company as the matter identified is a non-compliance. Need to discuss the impact on this matter and solve the issue as the Authority may direct not to continue so the going concern will be a concern.

(Expect only two aspects)

(03 marks)

(b)

- Review of Financial statements.
- Assurance on special purpose financial statements
- Assurance over adequacy of internal control.
- Assurance over Environmental matters.
- Assurance over regulatory compliances.
- System reliability reports.
- Assurance on integrated reporting.
- Assurance on sustainability reporting.

(Expect only two examples)

(02 marks)

(05 marks)

Suggested Answers to Question Four:

Chapter 02

(a)

Shopping.lk can now actively monitor social media content (such as WhatsApp, Facebook, TikTok, etc.) to gather timely insights on customer service, product quality, or service delivery issues. In this case, widely and immediately available social media content provides valuable insights into the public perceptions of the business's products and services, helping Shopping.lk avoid reputational damage by offering a management tool that can quickly address service and product quality issues before they lead to serious brand or franchise harm.

(03 marks)

(b)

1. Risk avoidance
2. Risk Acceptance
3. Risk Transfer
4. Risk Reduction
5. Risk Sharing

(Expect only two)

(02 marks)

(Total 05 marks)

End of Section A

Suggested Answers to Question Five:***Chapter 05 and 06*****(a)**

1. **Gross Profit Ratio:** GP Ratio has decreased from 30% to 27% due to decrease in sales.
2. **Sales variance:** Sales have decreased by 10% in 2025. Since this is a considerable decrease, it should be verified with supporting documents to confirm whether these sales have in fact occurred and need to verify with quantity reconciliation as well.
3. **Stock valuation:** Stock has been overstated in the financial statements. This has to be addressed when preparing audit plan.
4. **Non-Availability of audit evidence:** Some invoices are not available in the company.
5. Major changes in the client's business, organization or accounting system.
6. Changes in law, accounting standards or the firm's procedures.
7. Other relevant background information.
8. Problems encountered in previous years, and other points brought forward.
9. Current tax position.
10. Time and cost budgets and staffing plans.
11. Timetable and accounting assistance from the client.
12. Overall audit strategy.
13. Detailed audit approach for each major area, stating the degree of reliance on internal control; and control, analytical review and substantive procedures and giving approximate sample sizes for the main substantive procedures.

*(Expect only three matters)***(03 marks)****(b)**

1. Observe physical verification of inventory.
2. Cutoff analysis.
3. Check the valuation of inventory.
4. Checking physical inventory balance with system's balance.
5. Calculate the inventory residence period.
6. Check the sales invoices.
7. Check whether correct accounting treatments have been applied for the inventory.

*(Expect only four audit procedures)***(04 marks)****(c)**

The application of audit procedures to less than 100% of items within a population of audit relevance, such that all sampling units have a chance of selection to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

(03 marks)**(Total 10 marks)**

Suggested Answers to Question Six:

Chapter 07

(a) To assess the impact of the identified matters on the audit opinion of **SJ Lanka Construction (Pvt) Ltd.** for the year ended 31st March 2025, we need to analyze each issue in terms of:

1. **Materiality** – whether the misstatement or limitation is material.
2. **Pervasiveness** – whether it affects many elements of the financial statements or the financial statements as a whole.
3. **Nature of the issue** – whether it is a **misstatement** or a **limitation on scope**.

Matter 1: Inability to verify the inventory of Rs. 8 million

- **Nature: Limitation on audit scope** – no supporting documents or physical verification of inventory, and alternative procedures were not possible.
- **Materiality:** Rs. 8 million is **above the materiality threshold** of Rs. 2.5 million, which means it is **material**.
- **Pervasiveness:**
 - Inventory is a significant component of current assets.
 - If the auditor cannot obtain sufficient appropriate audit evidence regarding a **material** item, and it potentially affects several areas (e.g., cost of sales, profit), it could be considered **pervasive**.

Conclusion: This may lead to either:

- A **qualified opinion** due to **limitation on scope** if not pervasive, **OR**
- A **disclaimer of opinion** if the limitation is **material and pervasive**.

Matter 2: Misstatement in accounting for interest expense (Rs. 2.45 million)

- **Nature: Misstatement** – classification error: interest should have been **capitalized** (per LKAS 23) but was instead expensed.
- **Materiality:** **Rs. 2.45 million is close to the materiality threshold of Rs. 2.5 million, so it is still considered material.**
- **Pervasiveness:** This affects the profit before tax, finance cost, and property, plant & equipment (capital WIP), but is not pervasive across the financial statements.

Conclusion: This would result in a **qualified opinion** due to a **material misstatement**.

(06 marks)

(b)

1. To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.
2. To report on the financial statements, and communicate as required by the SLAUSS in accordance with the auditors findings.

(04 marks)

(Total 10 marks)

Suggested Answers to Question Seven:

Chapter 08

(a)

1. Self-Interest Threat

- Description: Kumara is financially benefiting from a business relationship (tourist transport services) that originated through the General Manager (Viraj) of the client (**RF Hotel (Pvt) Ltd.**), where **WA Associates** performs an internal audit. In this case Viraj has evolved to increase the audit fees by 40% which is significant amount. But if it is acceptable by both parties with rationale it is acceptable.
- Ethical Impact: This creates a direct financial interest, which may impair objectivity and professional judgment, as Kumara could be inclined to favor the client's management to protect his external income source.

2. Familiarity Threat

- Description: Kumara has developed a close personal and professional relationship with Viraj. Given that Kumara is part of the internal audit team and the fees were increased by 40% after this interaction, there is a risk that he may be overly sympathetic to Viraj's interests. Also in this scenario WA Associates is the internal auditor for last seven years period. Therefore work may be too familiar and the known people in there may be too familiar which will influence the profession account's judgement and behavior.
- Ethical Impact: This could compromise integrity, objectivity, and professional skepticism, as decisions or findings in the audit may be influenced by personal ties rather than facts.

(06 marks)

(b)

1. Segregation of Duties within the Audit Firm

- Assign a different partner or audit team (excluding Kumara) to conduct the internal audit of **RF Hotel (Pvt) Ltd.**, thus distancing Kumara from the client relationship.

2. Disclosure to Those Charged with Governance

- Fully disclose the nature of Kumara's **business relationship** (tourist transport service) with Viraj to the **Audit Committee or Board of Directors** of RF Hotel, allowing them to assess the potential conflict of interest.

3. Independent Review or Quality Control

- Arrange for an independent partner (not involved in the audit or business relationship) to review the internal audit work and reports, particularly any areas influenced by management (e.g., fee increases).

4. Restrict Non-Audit Business Dealings

- WA Associates should implement a **policy prohibiting audit partners** from entering into **external business relationships** with client management or deriving personal financial benefits through client referrals.

Firm wide safeguards

- Leadership of the firm that stresses the importance of compliance with the fundamental principles.
- Leadership of the firm that establishes the expectation that members of an assurance team will act in the public interest.
- Policies and procedures to implement and monitor quality control of engagements.
- Documented policies regarding the need to identify threats to compliance with the fundamental principles, evaluate the significance of those threats, and apply safeguards to eliminate or reduce the threats.
- Documented internal policies and procedures requiring compliance with the fundamental principles.
- Policies and procedures that will enable the identification of interests or relationships between the firm or members of engagement teams and clients.
- Policies and procedures to monitor and, if necessary, manage the reliance on revenue received from a single client.
- Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client.
- Policies and procedures to prohibit individuals who are not members of an engagement team from inappropriately influencing the outcome of the engagement.

(Expect to identify four safeguards)

(04 marks)

(Total 10 marks)

End of Section B

Suggested Answers to Question Eight:**Chapter 03****(a)****1. Control Environment**

This sets the tone of the organization and forms the foundation for all other components of internal control. It includes elements such as ethical values, management philosophy, organizational structure, and the assignment of authority and responsibility.

2. Risk Assessment

Risk assessment involves identifying and analyzing risks that may affect the achievement of objectives. It enables management to anticipate potential threats and implement effective controls to mitigate those risks.

3. Control Activities

These are the internal controls, which are designed to fulfill a particular objective. Generally, Control activities that may be relevant to an audit may be categorized as policies and procedures that pertain to the followings.

- Segregation of duties
- Physical controls
- Authorization and Approval
- Management controls
- Supervision controls
- Organization controls
- Arithmetic and Accounting controls
- Personnel Controls

4. Information and Communication

Information and communication are the process of capturing and exchanging the information needed to conduct, manage and control the company's operations. Therefore, the information and communication component of internal control is a necessary prerequisite for achieving management's objectives. To make effective decisions, managers must have access to timely, reliable and relevant information.

5. Monitoring

This refers to the assessment of the quality of internal control. Monitoring activities provide information about potential and actual breakdowns in control system that could make it difficult for an organization to accomplish its goals. Responsibility of monitoring internal controls rests with the board of directors of the company.

(Expect only two components)

(04 marks)

(b) (i)

- I. Manual correction of fingerprint data without approval
- II. Lack of segregation of duties – Kamal handling both attendance and advances, Both cashier work and petty cash payments were done by Ajith.
- III. Advances paid in cash without proper system-based records
- IV. Use of sales collection cash for petty cash payments
- V. Adjustment to the salary sheets were done manually without approval.

(Expect only four weaknesses)

(04 marks)

(ii)

- I. **Require documented supervisor or manager approval** for any changes made to fingerprint attendance records.
- II. **Separate duties** so that no one person has full control over both record keeping and cash handling.
- III. **Automate and record all staff advances** in a secure payroll or HR system, with approvals and receipts.
- IV. **Ensure that all daily sales collections are banked** intact, and petty cash is replenished through authorized channels only.
- V. **Proper approval should be taken to adjust salary sheets**

(Expect only four recommendations)

(04 marks)

(c)

There are inherent limitations in internal controls due to following reasons:

- Controls may not be well designed.
- Controls may not be implemented as required. Therefore even well designed control may not be able to achieve its objectives.
- Continue changes in operations risks. As a result of the predesigned controls may failed to address new risks.
- Cost of designing and implementing controls does not justify the benefits delivered from those controls.
- Poor risk awareness culture within the organization.

Therefore, LGPL cannot expect completely error free controls within organization.

(04 marks)

Step	Objective
Attendance Capturing	❖ Employees are only paid for work actually performed or days attended
Payroll Computation	❖ Only genuine employees are paid and no dummy employees ❖ Employees are paid at the correct rate

	❖ Deductions are accurately considered
Amendments	❖ Updated accurately to the correct employee
Payments	❖ Correct amounts are paid to the employees and other authorities such as tax authorities and provident funds ❖ Payments are made on time ❖ Payment is made to the correct employee
Recording	❖ All payroll related payments are recorded accurately in the correct period and in the correct accounts

(Expect only three objectives)

(03 marks)

(e)

Application Control	Example
1. Controls over input completeness	<ul style="list-style-type: none"> • Manual and programmed agreement of control totals • Document count • One-for-one checking of processed output to source documents • Programmed matching of input to an expected input controls file • Procedures over resubmission of rejected items
2. Controls over input accuracy	<ul style="list-style-type: none"> • Programs to check data fields (For example value, reference number, date) on input transaction for plausibility. • Digital verification <ul style="list-style-type: none"> ○ Reasonable test ○ Character test ○ Existence test ○ Necessary Information ○ Permitted Range • Manual scrutiny of output and reconciliation to source • Agreement of control totals
3. Controls over input authorization	<ul style="list-style-type: none"> • Manual checks to ensure information input is authorized • Input by authorized personnel
4. Controls over processing	<ul style="list-style-type: none"> • Similar controls to input must be in place when input is completed. (Ex, Batch reconciliation) • Screen warnings can prevent people logging out before processing is complete
5. Controls over master files and standing data	<ul style="list-style-type: none"> • One-to-one checking • Cyclical reviews of all master files and standing data • Record counts (No of documentation processed) and hash totals (For example, the total of all the payroll numbers) used when master files are used to ensure no deletions • Controls over the deletion of accounts that have no current balance

(Expect only three controls with an example for each)

(06 marks)

(Total 25 marks)

Suggested Answers to Question Nine:

Chapter 05 & 06

(a)

Revenue Recognition

- Large revenue from different streams (indoor, OPD, pharmacy).
- Risk of overstatement due to the CEO's bonus being tied to revenue.

Salaries and Doctor Fees

- Combined exceed 20% of revenue – may impact profit margin; possible risk of misclassification or understatement.

Related Party Transaction

- Loan given to parent company (Rs. 5 million) needs proper disclosure and fair presentation.

Decline in Profit Margins

- Requires analysis to determine if it's due to operational issues, increased costs, or possible misstatements

(04 marks)

(b)

THE OVERALL AUDIT STRATEGY MATTERS TO CONSIDER	
Characteristics of the engagement	<ul style="list-style-type: none">• Financial reporting framework• Industry-specific reporting requirements• Expected audit coverage (e.g. No. of locations)• Nature of the control relationships (e.g. Group Audits)• Nature of business segments• The reporting currency to be used• Availability of internal audit work• Use of service organizations (Business Process Outsourcing) and how they have designed controls• Audit evidences obtained from previous audits• Effect of information technology on audit procedures• Availability of client personal and data

Reporting objectives, timing of the audit and nature of communications	<ul style="list-style-type: none"> Entity's timetable for reporting Organization of meeting with management and those charged with governance Discussions with management and those charged with governance regarding the expected types and timing of reports Expected communication regarding the status of the audit throughout the engagement Expected communication with component auditors Expected communications with third parties
Significant factors, preliminary engagement activities and knowledge gained on other engagements	<ul style="list-style-type: none"> Determination of materiality Identification of areas identified with higher risk of material misstatement and its impact at overall financial statement level Results of previous audits Need to maintain professional skepticism Evidence of management's commitment to design, implementation and maintenance of sound internal control Volume of transactions Significant business developments Significant industry developments Significant changes in financial reporting framework Other significant recent developments
Nature, Timing and extent of resources	<ul style="list-style-type: none"> Selection of Engagement Team Assignment of work to team members Engagement budgeting

(Expect only three matters)

(06 marks)

(c)

Industry, Regulatory, and External Factors

- Health care regulations, pricing controls, and insurance practices.

Nature of the Entity

- Its operations, services offered (e.g., maternity care, pediatric services), size, and ownership and governance structure.

Internal Control System

- ERP usage, segregation of duties, and approval processes for billing, payroll, and payments. Implement controls specially for issues that have been reported by the internal auditor.

Financial Performance and Profitability

- Trends in revenue, expenses, margin changes, and key financial indicators.

The entity's objectives and strategies and those related business risk

The entity's selection and application of accounting policies, including its appropriateness and the consistency in the business and industry.

The significant contracts, the company has entered into which have an impact on the operations.

(Expect only four areas)

(04 marks)

(d)

1. Name of the client
2. The subject, purpose, or content of the working paper
3. The balance sheet date
4. The date of preparation
5. The reference to the working paper
6. Initial of the preparing officer
7. Initial of the reviewing officer
8. The Date of review
9. Evidence of the planning process including audit programmers and any changes there through.
10. Evidence of the auditors consideration of the work of internal audit and conclusions reached.
11. Analyses of transactions and balances
12. Analyses of significant ratios and trends
13. Identified and assessed risk of material misstatements.
14. A record of the nature, timing, extend and results of audit procedures.
15. Evidence that the work performed was supervised and reviewed
16. An indication as who performed the audit procedures and when they were performed
17. Details of audit procedures applied regarding components whose financial statements are audited by another auditor.
18. Information obtained in understanding the entity and its environment.

(Expect only five items)

(05 marks)

(e)

(i) Inspection

Definition: Examining records or physical assets.

Examples:

1. Inspect invoices and discharge summaries for a sample of indoor patient revenue to verify accurate billing.
2. Inspect HR files to confirm doctor contracts and salary details for payroll testing.
3. Inspection of bank statements.
4. Inspection of loan agreements.
5. Inspection of title deed of a land.

(ii) Analytical Procedures

Definition: Evaluating financial information by studying plausible relationships among financial and non-financial data.

Examples:

1. Compare current year revenue per bed with prior year and industry averages to identify unusual trends.
2. Perform ratio analysis (e.g., salary/revenue, profit margin) to investigate reasons for decreased profitability.
3. Anticipated results such as budgets and forecasts.

(Expect only two examples for each)



(06 marks)
(Total 25 marks)

End of Section C

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