



ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

AA3 EXAMINATION - JANUARY 2020

(AA34) PROCESSES, CONTROLS AND AUDIT

• **Instructions to candidates** (Please Read Carefully):

- (1) **Time Allowed:** Reading : 15 minutes.
Writing : 03 hours.

18-01-2020
Afternoon
[1.45 – 5.00]

No. of Pages : 06
No. of Questions : 09

- (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.**

SECTION A

Four (04) compulsory questions

(Total 20 marks)

Question 01

Kumara and **Muditha** are friends, graduated in Business Administration. They decided to commence a business of importing and selling stationery nearby their university.

You are required to:

- (a) **Identify** two(02) types of suitable business organizations **Kumara** and **Muditha** can establish to start their business. (02 marks)
- (b) **State** three(03) economic factors that may affect on the above given business. (03 marks)
(Total 05 marks)

Question 02

Under the going concern assumption, the financial statements are prepared on the assumption that the entity will continue its operations in the foreseeable future.

You are required to:

List three(03) examples for financial events or conditions and two(02) examples for operating events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.
(05 marks)

Question 03

Siva is an Audit Senior of the audit team auditing the financial statements of **HS Holding Ltd.** for the year ended 31st March 2019.

The following audit procedures have been performed by **Siva** on the related party transactions:

- Reviewed prior year working papers.
- Reviewed minutes of the board meetings.

You are required to:

- (a) **State** two(02) situations where auditor cannot be expected to detect all material related party transactions. (02 marks)
- (b) **List** three(03) audit procedures other than those stated above, that **Siva** would perform when auditing the related party transactions. (03 marks)
- (Total 05 marks)

Question 04

W. Associates, a firm of chartered accountants established and maintain a system of quality control at the firm level and individual audit engagements level. You have been appointed as an Audit Manager of **W. Associates** and works done by audit trainees are reviewed by you.

You are required to:

- (a) **State** two(02) activities included under “review” when conducting an audit engagement. (02 marks)
- (b) **State** three(03) elements of quality control system maintained at firm level. (03 marks)
- (Total 05 marks)

End of Section A

SECTION B

Three (03) compulsory questions

(Total 30 marks)

Question 05

Assurance engagement is an engagement in which a practitioner aims to obtain sufficient and appropriate evidence in order to express a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the subject matter information.

You are required to:

- (a) **Explain** what is meant by sufficient and appropriate evidence. (04 marks)
- (b) **Explain** three(03) key requirements which should be performed when accepting and continuing the assurance engagement. (06 marks)
- (Total 10 marks)

Question 06

You are a senior in charge of the audit of **George Associates**, a firm of Chartered Accountants, which conducts the audit of financial statements of **Sara Trading (Pvt) Ltd.** for the year ended 31st December 2019. The following information was included in audit file:

- (1) Audit materiality used at the planning stage was Rs.1,700,000/- based on profit.
- (2) The Company completed the construction of an office building on 01st October 2019 and it was available for use on that date. The cost of the construction of the building was Rs.120 million.
- (3) Buildings are depreciated over 30 years on straight line basis at cost.
- (4) This new office building was opened on 01st January 2020 and depreciation was charged from that date by the company.
- (5) The Company has capitalized borrowing cost of Rs. 1.5 million from 01st October 2019 to 31st December 2019 on this new building.

You are required to:

- (a) **Assess** the above matters on the audit opinion of **Sara Trading's** financial statements for the year ended 31st December 2019. (06 marks)
 - (b) **Recognize** the type of audit opinion to be expressed if the auditor is unable to obtain sufficient and appropriate audit evidence. (04 marks)
- (Total 10 marks)

Question 07

- (A) **Mahela (Pvt) Ltd.** is considering the change of the existing auditor (**RS Associates**) due to delay in delivering the audit report for the last financial year, and Managing Director of **Mahela (Pvt) Ltd.** is discussing with **TM Associates** to be appointed as the statutory auditor of the company for auditing the financial statements for the year ended 31st March 2019.

You are required to:

- (a) **Explain** two(02) procedures that **Mahela (Pvt) Ltd.** should follow when replacing the existing auditor (**RS Associates**). (04 marks)
 - (b) **Explain** two(02) procedures that **TM Associates** should perform after accepting the appointment as the Statutory Auditor. (04 marks)
- (B) The principle of confidentiality imposes an obligation on all professional accountants to refrain from using confidential information acquired as a result of professional and business relationships to their personal advantage or advantage of third parties. Nevertheless, there are circumstances where professional accountants may be required to disclose confidential information.

You are required to:

State two(02) situations where professional accountants may be required to disclose confidential information. (02 marks)

(Total 10 marks)

End of Section B

SECTION C

Two (02) compulsory questions.

(Total 50 marks)

Question 08

Nilashi has been recently recruited as an Assistant Accountant of **HL Hotels PLC**. **Nilashi** noted during her induction program that there are around 10,000 shareholders who are not involving in managing the hotel. The board of directors comprises 5 directors appointed by the shareholders of the company.

After following the induction program, the accountant informed **Nilashi** about the job description and the following aspects of the procurement process of the hotel:

- All capital nature items are purchased with the approval of Board of Directors.
- There are registered suppliers for supplying of all the items. Prices of the items do not vary unless the Finance Manager approves it through the procurement committee.
- When the need arises for inventory, it will be notified to the Stores Manager with system generated Request Notes (RNs). RNs are approved by the respective department heads.
- System generated Purchase Orders (POs) are raised by Assistant Accountant. When the value is less than Rs.200,000/-, it is approved by the accountant and the Finance Manager approves up to the value of Rs.1,000,000/-.
- At the time of receiving the items, Goods Received Notes (GRNs) are generated by the Stores Clerk and those are entered into the computer system on the same day.
- When payment is made on suppliers' invoices, it should be agreed with the PO and GRN before generating the payment voucher by the assistant accountant.
- Payment vouchers are approved and cheques are signed by the signatories as per the limits set.

The company uses computerized accounting system for its financial reporting.

You are required to:

- (a) **State** four(04) guidelines to be followed by Directors that have been highlighted by the Code of Best Practice on Corporate Governance. (04 marks)
 - (b) **State** two(02) committees that should be established by **HL Hotels PLC** as per the corporate governance guidelines applicable for listed entities in Sri Lanka. (02 marks)
 - (c) **Identify** five(05) strengths in the procurement process of **HL Hotels PLC**. (05 marks)
 - (d) **State** an objective for each of those strengths identified in (c) above. (05 marks)
 - (e) **List** two(02) elements of control environment and three(03) control activities to be established by **HL Hotels PLC**. (05 marks)
 - (f) **List** two(02) general controls to be available to prevent unauthorized amendments to data files and two(02) application controls to be available to control over accuracy of inputs. (04 marks)
- (Total 25 marks)

Question 09

You are the senior in charge of the statutory audit of **Srina Fabrics PLC** which manufactures and sells fabrics in the local market. The information about the company is available in its web site. The following information relating to the audit engagement was extracted from the audit planning memo and related working papers with respect to the audit of the financial year ended 31st December 2019:

- The Company's debtors consist of corporate customers and they are given 30 days of credit period.
- Debtors' balance appeared in the financial statements as at 31st December 2019 was Rs.128 million.
- Age analysis of debtors as at 31st December 2019 was as follows:

Less than 30 days (Rs. in million)	30 to 60 days (Rs. in million)	60 to 90 days (Rs. in million)	90 to 365 days (Rs. in million)	Over 365 days (Rs. in million)
28	12	32	48	08

- It was known by 10th January 2020, a debtor with the balance of Rs. 80 million as at 31st December 2019, has significantly reduced the orders due to his business restructuring.
- Only Rs. 1.5 million was received subsequently from debtors by 15th January 2020.
- An impairment provision of 100% is made for debtors' outstanding balance for more than 365 days.
- Sales Executive receives the orders from the customers and accounts executive is informed that through an email to raise the invoices. Revenue is recognized at the same time.
- Customers collect the goods from the Company's factory and at the same time customers acknowledge the invoice copies that goods are received and then those are sent to the finance department.
- Bonus is paid for the CEO and senior managers on achieving the budgeted sales for the year.

You are required to:

- (a) **State** four(04) reasons why proper planning of an audit is required. (04 marks)
- (b) **List** five(05) sources that can be used to get an understanding on **Srina Fabrics PLC**. (05 marks)
- (c) **Identify** six(06) areas that you need special attention in performing audit procedures of **Srina Fabrics PLC**. (06 marks)
- (d) **List** four(04) audit procedures that need to be performed in auditing debtors' balance. (04 marks)
- (e) **Explain** three(03) types of audit procedures for obtaining the audit evidence. (06 marks)

(Total 25 marks)

End of Section C

ACTION VERB CHECK LIST

Knowledge Process	Verb List	Verb Definitions
Level 01 Comprehension Recall & explain important information	Define	Describe exactly the nature, scope, or meaning.
	Draw	Produce (a picture or diagram).
	Identify	Recognize, establish or select after consideration.
	List	Write the connected items one below the other.
	Relate	To establish logical or causal connections.
	State	Express something definitely or clearly.
	Calculate/Compute	Make a mathematical computation
	Discuss	Examine in detail by argument showing different aspects, for the purpose of arriving at a conclusion.
	Explain	Make a clear description in detail revealing relevant facts.
	Interpret	Present in an understandable terms.
	Recognize	To show validity or otherwise, using knowledge or contextual experience.
	Record	Enter relevant entries in detail.
Summarize	Give a brief statement of the main points (in facts or figures).	

Knowledge Process	Verb List	Verb Definitions
Level 02 Application Use knowledge in a setting other than the one in which it was learned / Solve closed-ended problems	Apply	Put to practical use.
	Assess	Determine the value, nature, ability, or quality.
	Demonstrate	Prove, especially with examples.
	Graph	Represent by means of a graph.
	Prepare	Make ready for a particular purpose.
	Prioritize	Arrange or do in order of importance.
	Reconcile	Make consistent with another.
	Solve	To find a solution through calculations and/or explanation.

Knowledge Process	Verb List	Verb Definitions
Level 03 Analysis Draw relations among ideas and compare and contrast / Solve open-ended problems.	Analyze	Examine in detail in order to determine the solution or outcome.
	Compare	Examine for the purpose of discovering similarities.
	Contrast	Examine in order to show unlikeness or differences.
	Differentiate	Constitute a difference that distinguishes something.
	Outline	Make a summary of significant features.