

**ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA**  
**LEVEL III EXAMINATION - JANUARY 2023**  
**(303) FINANCIAL CONTROLS & AUDIT**

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

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

25-02-2023  
Afternoon  
[01.45 – 05.00]

No. of Pages : 07

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**

(Total 20 marks)

**Question 01**

A new director has been appointed to the board of **ABC PLC**. During the inaugural session conducted by the secretary to the board, the secretary stated that “shareholders are the stewards of the company and therefore, the company is the agent of shareholders”:

**You are required to:**

- (a) **Explain** whether you agree with the above statement made by the secretary with reasons thereon. (03 marks)

- (b) **Explain** the term “Fiduciary relationship”. (02 marks)

(Total 05 marks)

## Question 02

**Madara (Pvt) Ltd.** engages in the sewing and exporting of branded textiles to European countries. The company has faced the following risks during the last 6 months:

- (1) Breakdown of machinery during the peak season.
- (2) Intentionally presenting inaccurate information in the financial statements.
- (3) Employee attached to the customer relationship department fails to work according to established procedures of the organization.
- (4) Customers rejected few products due to the poor quality.
- (5) Rapid increase in interest rates of the loan obtained to finance the working capital requirement.

**You are required to:**

**Identify** the type of risk to which each of the above risk can be categorized and the most appropriate risk mitigating technique for each identified risk. (05 marks)

## Question 03

A Three-Party relationship is one of the five elements of an assurance engagement. These three parties are; the responsible party, user and the practitioner.

**You are required to:**

**Explain** the respective role of these three parties and how they relate to each other. (05 marks)

## Question 04

The firm should establish and maintain a system of quality control at the firm level and on an individual audit level.

**You are required to:**

- (a) **Explain** the leadership responsibilities for quality within the firm as an element of the system of quality control. (03 marks)
- (b) **State** two(02) matters to be considered under the supervision on an individual audit engagement. (02 marks)

(Total 05 marks)

---

*End of Section A*

---

## **SECTION B**

(Total 30 marks)

### **Question 05**

**Star Lanka (Pvt) Ltd.** (*“the company”*) is engaged in manufacturing of soap and distribute through dealers in Western and Central provinces. The company imports raw materials from India and few items are purchased from local market. There are 76 employees working in the Factory, 12 in stores transport unit and 5 in accounts department.

No external audits have been carried out since the incorporation of the company in 2020 due to the pandemic prevailed in the country.

**Ahamed**, the Managing Director of the company requests your firm of chartered accountants to perform the external audit of the company.

As an audit senior, you are aware that adequate planning is required for these type of engagements in several ways. Further, you are aware that the auditor should obtain an understanding of the entity and its environment in order to be able to assess the risks of material misstatements.

**You are required to:**

- (a) **Identify** three (03) benefits that an auditor would derive by adequate planning of an audit. (03 marks)
  - (b) **State** three(03) areas that the auditor shall obtain an understanding of **Star Lanka (Pvt) Ltd.** (03 marks)
  - (c) **Explain** two(02) preliminary engagement activities that the auditor should perform at the beginning of the current audit engagement. (04 marks)
- (Total 10 marks)

### **Question 06**

When **Aurther Silva & Co.** (a firm of Chartered Accountants), the auditor of **Bell PLC** presented the audit plan to the Audit Committee, the Chairman of the Audit Committee stated that the auditor is responsible for detecting “frauds” and inquired about the auditor’s approach in detecting frauds in the company.

When performing stage of the audit has been started, the auditor used an e-audit tool in performing the audit of **Bell PLC**. E-audit tools had different templates at different levels of the audit, which require documentation of communications with “Those Charged with Governance (TCWG)”. The audit team had documented the matters under discussion with TCWG.

**You are required to:**

- (a) **Explain** the responsibility of the auditor in preventing and detecting fraud in an entity. (04 marks)
  - (b) **Identify** two(02) procedures to be followed by the auditor to reduce the audit risk on fraud. (02 marks)
  - (c) **Explain** two(02) areas to be communicated with TCWG in conducting the audit. (04 marks)
- (Total 10 marks)

**Question 07**

**Peters & Co.**, an audit firm with a single partner **Piyal Peters**, one manager and 20 audit trainees. The firm has been approached by **Reliable PLC (RPLC)** to accept the appointment as their auditor. **RPLC** is a large-scale life insurance company. As the manager of the audit firm, you have gathered some vital information before accepting the audit engagement.

It was published in Colombo Stock Exchange website that the audited financial statements of **RPLC** for the previous year have been re-issued due to a significant error correction and unacceptable accounting practices. Sri Lanka Accounting & Auditing Standards Monitoring Board also had issued a “letter of warning” during the current year relating to providing false information to them by **RPLC**. Further, net profit margin of the company is very high comparing with other similar life insurance companies.

The audit partner has asked your advice in accepting audit engagement of **RPLC** as an audit client.

**You are required to:**

- (a) **Discuss** three(03) matters you will consider and communicate to the partner in accepting **RPLC’s** audit engagement. (06 marks)
  - (b) **Explain** four(04) safeguards available to an auditor in relation to threat of professional competence and due care in accepting a new audit client. (04 marks)
- (Total 10 marks)

---

*End of Section B*

---

## SECTION C

(Total 50 marks)

### Question 08

After working in a private hospital in Dubai for a number of years, **Dr. Roshan** came back to Sri Lanka in the last year. In December 2021, he established a private limited liability company, **Osu Medura (Private) Ltd.** to operate a chain of pharmacies and has set up three pharmacies in Maharagama, Nugegoda and Avissawella.

Maharagama Branch is the main branch, and it handles purchasing and suppliers' payments. All three branches are using a tailor-made software for stock update which is very reliable, and all the information are available. **Dr. Roshan** can check the stock balance through his computer and place the orders. He recruited **Kalpani** who has completed a pharmaceutical course and she has been working as a pharmacist for a number of years. **Kalpani** enters all goods receiving notes to the stock module.

Supplier selection, placing orders and cheques writing based on the suppliers' invoices are all handled by **Dr. Roshan** himself. No credit sales take place in any of the branches. Total collection deposit to the bank by the cashier at the end of the day using the CDM deposit machines. Coins are kept in a separate drawer.

Recently **Dr. Roshan** reached out to your audit firm and request to help him to set up the finance department for his company. You were made to understand that he himself is involved in accountant's work, but he lacks the capacity to handle it with the increased business activities. Since, the company is making sufficient profits to make salaries, he wants to handle operations without his involvement and monitor everything through the available software package.

Further, **Dr. Roshan** inquired you regarding the "control environment".

#### **You are required to:**

- (a) **Identify** four(04) internal control weaknesses of **Osu Medura (Pvt) Ltd.** (04 marks)
- (b) **Explain** the meaning of "system of internal control" to **Dr. Roshan.** (04 marks)
- (c) **State** any five(05) elements of control environment. (05 marks)
- (d) **Explain** three(03) key business processes required for **Osu Medura (Pvt) Ltd.** (06 marks)
- (e) **Identify** three(03) application controls with an example each that **Osu Medura (Pvt) Ltd.** can consider. (06 marks)

(Total 25 marks)

## Question 09

**Toys PLC (TPLC)** is involved in import and wholesale of toys. Due to current adverse situation in the country, work from home arrangements are implemented and as a result the internal controls in **TPLC** are not operating effectively. When performing the preliminary analytical review (PAR) relating to sales, sales commission, trade debtors and inventory, fluctuating relationships have been identified and those have been discussed with the management.

**TPLC** was not in a position to import during the year due to import restrictions imposed by the government of Sri Lanka. One year import loans taken by **TPLC** were fall due within the year but **TPLC** was unable to settle the dues. Bank is not willing to extend the term.

**TPLC** has only few suppliers, but **TPLC** is struggling to settle the import creditors and the creditors have informed that penalty interest will be charged on the balances overdue. The auditor has called for the negative third-party confirmations from trade creditors. This was the sole audit procedure for trade creditors.

Debtors take long time to settle, and the marketing department has informed the finance department that some of the customers have closed their operations. During the statutory audit, auditor has called for the external confirmations from trade debtors as risk of the material misstatements was decided to be high.

Financial Statements have been prepared by **TPLC** using the going concern assumption. However, the auditor's assessment of going concern assumption indicates that use of going concern assumption is not appropriate and the Financial Statements should have been prepared as not a going concern. If not, a modified opinion would have been expressed. **TPLC** has requested the auditor not to modify the financial statements and to include either other matter paragraph or an emphasis of a matter paragraph.

### You are required to:

- (a) **Explain** three(03) types of audit procedures other than calling for external confirmations to obtain audit evidences. (06 marks)
- (b) **Explain** what is meant by negative confirmation request. (02 marks)
- (c) **Identify** two(02) analytical procedures that can be carried out by the auditor in comparison of **TPLC's** financial information. (02 marks)
- (d) **Identify** five(05) events and conditions that may cast doubt about the going concern assumption. (05 marks)
- (e) **Assess** the request made by the company, considering the requirements relating to emphasis of a matter paragraph. (04 marks)
- (f) **Explain** the suitability or non-suitability of issuing a qualified opinion on **TPLC's** financial statements. (06 marks)

---

*End of Section C*

(Total 25 marks)

## **ACTION VERBS CHECK LIST**

Level of Competency	Description	Action Verbs	Verb Definitions
<b>Knowledge (1)</b>	Recall Facts and Basic Concepts.	<b>Draw</b>	Produce a picture or diagram.
		<b>Relate</b>	Establish logical or causal connections.
		<b>State</b>	Express details definitely or clearly.
		<b>Identify</b>	Recognize, establish or select after consideration.
		<b>List</b>	Write the connected items.

Level of Competency	Description	Action Verbs	Verb Definitions
<b>Comprehension (2)</b>	Explain & Elucidates Ideas and Information.	<b>Recognize</b>	Show validity or otherwise, using knowledge or contextual experience.
		<b>Interpret</b>	Translate into understandable or familiar terms.
		<b>Describe</b>	Write and communicate the key features.
		<b>Explain</b>	Make a clear description in detail using relevant facts.
		<b>Define</b>	Give the exact nature, scope or meaning.

Level of Competency	Description	Action Verbs	Verb Definitions
<b>Application (3)</b>	Use and Adapt Knowledge in New Situations.	<b>Reconcile</b>	Make consistent / compatible with another.
		<b>Graph</b>	Represent by graphs.
		<b>Assess</b>	Determine the value, nature, ability or quality.
		<b>Solve</b>	Find solutions through calculations and/or explanation.
		<b>Prepare</b>	Make or get ready for a particular purpose.
		<b>Demonstrate</b>	Prove or exhibit with examples.
		<b>Calculate</b>	Ascertain or reckon with mathematical computation.
		<b>Apply</b>	Put to practical use.

Level of Competency	Description	Action Verbs	Verb Definitions
<b>Analysis (4)</b>	Draw Connections Among Ideas and Solve Problems.	<b>Communicate</b>	Share or exchange information.
		<b>Outline</b>	Make a summary of significant features.
		<b>Contrast</b>	Examine to show differences.
		<b>Compare</b>	Examine to discover similarities.
		<b>Discuss</b>	Examine in detail by arguments.
		<b>Differentiate</b>	Constitute a difference that distinguishes something.
		<b>Analyze</b>	Examine in details to find the solution or outcome.