

ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

LEVEL III EXAMINATION - JULY 2023

(303) FINANCIAL CONTROLS & AUDIT

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

	19-08-2023
	Afternoon
	[01.45 – 05.00]
	No. of Pages : 07
	No. of Questions : 09
- (1) **Time Allowed:** Reading : 15 minutes.
Writing : 03 hours.
- (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

Trust PLC is a listed company and it has appointed the current auditor seven (07) years ago who is a sole practitioner. Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB) has sent a letter to the Company listing ten (10) significant non-compliances with accounting standards. The Board of Directors (BOD) has requested a recommendation from the Audit Committee (AC) on re-appointment of the auditor.

You are required to:

- (a) **State** three(03) functions of the audit committee of **Trust PLC**. (03 marks)
 - (b) **Identify** two(02) benefits the audit committee can provide to the BOD of **Trust PLC** in relation to external auditor of the company. (02 marks)
- (Total 05 marks)

Question 02

Glenrock (Pvt) Ltd. (Glenrock) operates a hotel with 45 luxury rooms. The Managing Director of **Glenrock** has some concerns over the following risks:

- (1) Carrying considerable amount of money to deposit to the bank.
- (2) Continues losses of the restaurant which was at a separate location.
- (3) Hotel industry is a vulnerable industry in Sri Lanka now.

You are required to:

Explain a technique each that can be used for mitigating the risks identified above. (05 marks)

Question 03

Senyan Engineering (Pvt) Ltd. (Senyan) commenced its operations in 2020 but due to the crisis conditions in the country, there had been a delay in recruiting an accountant resulted in delay in preparing of annual accounts of **Senyan**. Now the annual accounts are ready and the managing director of **Senyan** has requested your audit firm to conduct the annual audit for the financial years 2020/21 and 2021/22.

You are required to:

Explain three(03) key aspects and requirements applicable when accepting and managing an assurance engagement. (05 marks)

Question 04

The objective of the firm is to establish and maintain a system of quality control to provide it with reasonable assurance that the firm and its personal comply with professional standards and applicable legal and regulatory requirements. There are some key elements of a system of quality control of a firm.

You are required to:

Explain two (02) key elements of a system of quality control of a firm. (05 marks)

_____ *End of Section A* _____

SECTION B

(Total 30 marks)

Question 05

Extract of the statement of financial position as at 31st March 2023 of **Intel Lanka (Pvt) Ltd.** ("**Intel**") is given below:

As at 31st March 2023	<i>(Rs.'000)</i>
Property, Plant & Equipment at Carrying Value	570
Inventories	2,850
Other Current Assets	420
Total Assets	3,840
Stated Capital	10
Retained Earnings	3,100
Current Liabilities	730
Total Equity and Liabilities	3,840

You are being the audit manager of the engagement, is required to participate the initial audit discussion with the finance manager of **Intel**. This time entirely a new team will be conducting the audit including you. Your engagement partner has insisted that it is important to have consistency in the quality of engagement performance with new team.

Intel has not invited auditor for the physical stock verification although your firm has participated in the previous years. You have noted that the value of inventories is exceptionally high compared to previous year. The finance manager informed you that directors have decided to value the stock at selling price.

You are required to:

- (a) **Discuss** how the physical stock verification and the method of valuation of inventories will affect the auditor’s report of **Intel** for the year ended 31st March 2023. (06 marks)
- (b) **State** four(04) matters that need to be considered in forming the auditor’s opinion. (04 marks)
- (Total 10 marks)

Question 06

- (a) **Good Bank PLC** (*the Bank*) wishes to appoint **Rex & Filix (R & F)** as their auditor for the financial year 2023/24. The financial statements of the Bank for 2022/23 carries a qualification in the audit report on non-provision of impairment relating to loans and advances in accordance with the principles of accounting standards. One partner of **R & F** is ready to accept the engagement while the other partner has a doubt on whether acceptance of the audit is appropriate considering the qualification.

You are required to:

Assess the possibility of accepting the audit of **Good Bank PLC** as a new client. (05 marks)

- (b) The audit partner of **Centra PLC** (*the company*) was seen in several corporate events of the company. Further, the CEO of the company has invited the audit partner to the wedding of his daughter. This situation has been brought to the notice of the senior partner of the firm. Audit partner argues that other than attending the invited events, he does not have any other relationship or conflict and he is fully independent from **Centra PLC**.

You are required to:

Explain the audit partner the concept of “independence”. (05 marks)

(Total 10 marks)

Question 07

The recent purchase list of **RT Hotels** is given below:

Date	GRN No.	Supplier Name	Amount (Rs.)
03.10.2022	4765	Rashi Fruits stall	52,760
04.01.2023	4766	Rizan Meat shop	105,460
04.01.2023	4767	Fresh vegetables Mart	22,900
06.02.2023	4769	Kusum Hardware	17,800
07.03.2023	4770	Wijaya Distributors	47,900

The credit period given by the suppliers is 30 days.

The Trade Creditors' list given below is as at 10th May 2023:

(Rs.)

Name	Total Outstanding	0-30 Days	30-60 Days	More than 60 Days
Disna Tea Shop	22,700			22,700
Rashi Fruits stall	52,760			52,760
Rizan Meat shop	154,620	142,320		12,300
Fresh vegetables Mart	22,900		22,900	
Kusum Hardware	17,800	17,800		
Total	270,780	160,120	22,900	87,760

Assume you are the auditor of **RT Hotels** and currently you are performing the audit for the year ended 31st March 2023.

You are required to:

- (a) **Identify** two(02) suppliers that you need to obtain external confirmations and **Explain** the reasons for your selection. (04 marks)
- (b) **List** three(03) audit procedures that need to be performed in auditing of trade creditors other than obtaining external confirmation. (03 marks)
- (c) **Explain** the auditor's responsibility on subsequent events. (03 marks)
- (Total 10 marks)

End of Section B

SECTION C

(Total 50 marks)

Question 08

D Fashion Private Ltd. (*the company*) is a leading company in wholesale garment industry. **Mr. Danushka**, Director and the main shareholder of the company started this business 12 years ago with one sawing machine. When the demand for his garments increased instead of investing for his own machinery and buildings, he sub-contracted the manufacturing process to household garment manufacturers. Today the company is having over 50 registered sub-contractors. Over 50,000 units of garments are sold monthly for leading retail garment sellers.

When the orders are received from the customers, designing team start the designing process. With the customer's approval of the design, it is handed over to a sub-contractor. Next step is the sample approval. Sub-contractor is required to produce 2 samples for the approved design. Once the sample is approved by the company, the sub-contractor can start the commercial manufacturing.

One month credit period is given to customers. However, as at 31st March 2023 there was an outstanding balance of Rs. 14 million which was outstanding for more than 6 months. The sub-contractors do not provide credit period. It is required to provide advance payments to the sub-contractors if the order value exceeds Rs. 1 million.

There are five (05) members in finance team; the accountant, 3 bookkeepers and a cashier. In-house developed software is used to record inventories movements and finance transactions. Once the GRN is approved, payments are paid by the accountant to sub-contractors. However, there are payable balances in accounts of two sub-contractors. There were instances that customers have rejected the entire stock due to specification changes with the approved design and sample. Over Rs. 15 million stock is in stores that has not been collected by the customers.

Mr. Danushka has requested your audit firm to conduct an internal audit and provide suggestions to improve any weak areas.

You are required to:

- (a) **Explain** three(03) signs that may indicate significant deficiencies in internal control system of **D Fashion (Pvt) Ltd.** (06 marks)
 - (b) **Explain** three(03) control activities that can be implemented by **D Fashion (Private) Ltd.** (06 marks)
 - (c) **Explain** two(02) preventive controls that can be suggest to **D Fashion (Pvt) Ltd.** (04 marks)
 - (d) **Explain** two(02) key business processes you have identified in **D Fashion (Pvt) Ltd.** (05 marks)
 - (e) **State** two(02) application controls with an example for each that can be used to verify the accuracy of GRNs in **D Fashion (Pvt) Ltd.** (04 marks)
- (Total 25 marks)

Question 09

Eran & Pep (E&P) a firm of Chartered Accountants who has been the external auditor of **Yes Finance PLC (YF)** for 3 years. The auditor was re-appointed for the year ended 31st December 2022. You are the engagement manager, and the engagement partner has discussed the following new updates relating to the audit of 2022:

- (1) Management has requested to provide auditor's suggestion for improvements to the management letter points
- (2) The company is a registered finance company and during the year under review, the company has started pawning centers in its existing branches which is a growing business.

- (3) The Central Bank of Sri Lanka (CBSL) has issued significant new directions which would have an impact on the capital adequacy of the finance companies. **YF** has been struggling to keep up with the capital requirements and poor capital levels would lead the CBSL directing **YF** to be amalgamated with a big player in the industry.
- (4) The company has earned a marginal profit for the year 2022, comparing with other financial institutions.
- (5) It has been a tough year for finance companies with moratoriums and recovery actions being limited due to CBSL directions which could have a direct impact on the impairment provisions.
- (6) Few Senior Managers resigned from the company and those positions have not been filled since 6 months.
- (7) During the year, **YF** acquired 25% of shares held by **Sooriya (Pvt) Ltd.** which is operating a television channel.
- (8) New CEO was appointed during the year 2022 and his bonus is determined based on the revenue achieved during the year.

At the planning meeting, audit senior has presented that the applicable materiality for the audit is Rs.23 million and it is based on total assets.

You are required to:

- (a) **Identify** five(05) areas that need special attention in performing the audit procedures at **YF**. (05 marks)
 - (b) “During the meeting with the new CEO, he mentioned that the auditor’s objective should be to identify all errors and frauds in financial reporting.”
Assess the above statement. (05 marks)
 - (c) **State** four(04) factors that may affect the establishment of materiality based on an appropriate benchmark. (04 marks)
 - (d) **Identify** five(05) “Industry and regulatory factors” indicated in the above scenario which auditor needs to consider in obtaining an understanding of the entity and its environment. (05 marks)
 - (e) **State** six(06) audit procedures that can be applied in reviewing the going concern at **YF**. (06 marks)
- (Total 25 marks)

End of Section C

ACTION VERBS CHECK LIST

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

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

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

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