



ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA
LEVEL III EXAMINATION - JANUARY 2024
(303) FINANCIAL CONTROLS & AUDIT

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

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

10-02-2024
Afternoon
[01.45 – 05.00]

- (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.**

No. of Pages : 07

No. of Questions : 09

SECTION A

(Total 20 marks)

Question 01

Ariyadasa is the sole proprietor of **Ransela Enterprise** which is a leading textile importer. He has been successfully conducting his trading business for a period of 42 years. He feels this is the time to get the involvement of his daughters and son to the business legally.

You are required to:

- (a) **State** two(02) types of business organizations that can be considered by **Ariyadasa** to convert **Ransela Enterprise** to achieve his objective. (02 marks)
- (b) **Identify** the following legal aspects of the types of business organizations identified in (a) above:
- (i) Taxation.
- (ii) Liability. (03 marks)

(Total 05 marks)

Question 02

D Fashions (Pvt) Ltd. (“the Company”) has established a Risk Management Framework by appointing a management team to identify the business risks and to suggest timely implementation of actions to mitigate the risks of the organization. The objective of this is to ensure the continuity of smooth operations of the company.

You are required to:

Explain two(02) opportunities / benefits of using a Risk Management Framework. (05 marks)

Question 03

Assurance engagements play an important role in providing users of financial information, that the information is reasonably accurate and has been properly prepared and presented. There are two types of assurance engagements as reasonable assurance engagement and limited assurance engagements.

You are required to:

- (a) **Explain** the three (3) parties of an assurance engagement. (03 marks)
 - (b) **State** two(02) differences between a “Reasonable Assurance Engagement” and a “Limited Assurance Engagement”. (02 marks)
- (Total 05 marks)

Question 04

A system of quality control is a set of policies & procedures designed to ensure a consistent quality of work from the audit firm. There are six elements of a system of quality control and relevant ethical requirements is an element of a system of quality control.

You are required to:

- (a) **Explain** the independence to be maintained by a firm under relevant ethical requirements. (03 marks)
 - (b) **State** two(02) matters to be considered under “Review” of an individual audit engagement. (02 marks)
- (Total 05 marks)

End of Section A

SECTION B

(Total 30 marks)

Question 05

Nim Holdings (Pvt) Ltd. (NHL) is engaged in constructions and civil engineering services. External audit of **NHL** was conducted by your firm for the past six (6) years period. Due to the prevailing situation of the country, **NHL’s** revenue has decreased continuously over the past three (3) years. Due to the limited opportunities in the construction industry, the Managing Director has invested on a gem business by importing gem cutting machinery in 2022. The senior managers of **NHL** have completed a technical course relating to gem. **NHL** has purchased gems through local miners and after completing the cutting process, those have been exported successfully during the last few months of the financial year 2022/23.

You have been given the draft set of financial statements for the year ended 31st March 2023 which includes 90% revenue from gem exports.

You are required to:

- (a) **Explain** three(03) matters that the auditor may consider when establishing an overall audit strategy. (06 marks)
 - (b) **Identify** four(04) areas the auditor of **NHL** shall need to understand when performing the audit of the financial statements. (04 marks)
- (Total 10 marks)

Question 06

Your firm has been appointed as the auditors of **RF Hotels**. During the audit, you noted that the following balances were included in the outstanding debtors' list:

Name of the Debtor	Total (Rs.)	0-30 Days	30-90 Days	90-120 Days	Above 120 Days
AB Tourists	1,850,300	500,000	-	-	1,350,000
Lanka Visitors	(650,000)	(650,000)	-	-	-
Gulf Tours	230,000	80,000	50,000	50,000	50,000

When you look in to the details of the above list, you discovered that debtors' balances are not in agreement with the confirmations received from debtors. Sales invoices have not been posted for **Lanka Visitors**. Although **AB Tourists** has paid their long outstanding balance of Rs.1,350,000/-, respective cash amount has not been credited to company's bank account. When you communicate these matters to Managing Director, he requests you to check in detail all the transactions and provide him a detail report whether any fraud has occurred.

You are required to:

- Define** the Fraud. (03 marks)
 - Explain** the responsibility of the auditor regarding Managing Director's request on frauds of Financial Statements. (04 marks)
 - State** three(03) conditions or events that increase the risk of fraudulent financial reporting. (03 marks)
- (Total 10 marks)

Question 07

Shiran Garment (Pvt) Ltd. (SGL), is considering obtaining a low interest loan of Rs.100 million from a state bank. The Managing Director of **SGL** has requested your firm to undertake the assignment of preparing financial forecast for next 5 years to obtain the loan. **SGL** has faced financial difficulties due to import restrictions on garments and this loan is required to meet the working capital requirements of **SGL**.

External audit was conducted by another audit firm but soon after you complete the financial forecast for bank loan, the Managing Director of **SGL** has decided to handover the external audit engagement of **SGL** for next financial year also to your firm. If the audit of **SGL** is accepted, 25% of revenue of your firm is from **SGL**.

You are required to:

- Explain** two(02) key aspects and requirements that you need to consider when accepting the external audit engagement of **SGL**. (03 marks)
 - Assess** two(02) threats to compliance with fundamental principles of ethics with reference to the above facts. (04 marks)
 - Identify** three(03) safeguards implemented in your firm to eliminate / reduce the above threats to an acceptable level. (03 marks)
- (Total 10 marks)

SECTION C

(Total 50 marks)

Question 08

Plumbing World Ltd. (PWL) is in the wholesale and retail business of plumbing equipment. Purchasing Executive places orders based on the Inventory Officer's request and the Purchase Order is approved by the Purchasing Manager. Then the documents are sent to Assistant Accountant for recording. Purchases are made from the suppliers registered with the company. However, the company has no proper controls in place in selecting suppliers for registration. The company maintains large inventory of less value and small inventory items with high value and therefore access to stores is protected via bio metrics. The management reviews daily inventory level reports. Monthly physical inventory counts are taken by inventory officer and stocks are adjusted in the system based on physical inventory count.

Internal auditor has reported that certain controls have not been implemented by the relevant staff due to not understanding the risk behind the controls. Quality of inventory is checked by the Inventory Officer, but he has no adequate knowledge to check quality of certain items. Due to his lack of knowledge, the company has made losses on low quality goods. The company is currently considering employing a quality specialist and the salary expectation of a such specialist is high.

Daily sales report could not be generated from the sales system. Further, the customers have complained that the price stated in the sales invoice sent to them is different from the quotation. The sales director discovered that price list updated to the sales system contained errors and therefore differences exist with the approved price list. Further, some of the debtor balances do not appear in the debtors' list. This is due to sales staff deleting the customer from the master file due to no recent orders received from the customer. Further, the sales system was out of order for a day due to a virus attack and some of the data got lost and backups were not available to recover those data.

You are required to:

- (a) (i) **Identify** five(05) internal control weaknesses of **PWL**. (05 marks)
- (ii) **State** a recommendation each to overcome the weaknesses identified in (a)(i) above. (05 marks)
- (b) (i) **Identify** four(04) control activities that can be implemented in relation to purchasing and inventory of **PWL**. (04 marks)
- (ii) **Explain** the meaning of "Effectiveness and Efficiency of Operations" as an objective of an internal control system. (03 marks)
- (c) **State** four(04) inherent limitations of an internal control system. (04 marks)
- (d) **List** two(02) application controls and two(02) general controls to be implemented in relation to the sales system of **PWL**. (04 marks)

(Total 25 marks)

Question 09

(A) **Perera** is the sole practitioner at **Perera & Co.**, an audit firm. The firm is in the process of developing a guideline for analytical procedures. Training Manager has identified the following requirements as appropriate:

- Comparison of the entity's financial information with relevant other financial information
- Identify relationships between financial and non-financial information using trend analysis.

While conducting the audit of **A Ltd.** for the year ended 31st March 2023, disclosure of related party transaction has been assigned to a junior member of the audit team by **Perera**. Audit documentation included the following:

- Risk assessment was not performed since it is only a disclosure made in the financial statements. Previous year's related party disclosure notes have been updated with current year balances obtained from the ledger. The following related party transactions were occurred during the current year.
 - Long term loan obtained from **D Ltd.** – Rs.2,000,000/-.
 - Short term advances given to a related company – **D Ltd.** – Rs.1,250,000/-.
 - Investment in **D Ltd.** - Rs. 50 million.
 - Dividends received from **D Ltd.** – Rs.500,000/-.
- As audit procedures, confirmations were called for loan balances & investment certificates and dividend receipts were checked. The above balances were disclosed in the financial statements and the management representation on the above balances were obtained.

You are required to:

- (a) **Explain** two(02) analytical procedures that can be included under given requirements as identified by the training manager. (03 marks)
- (b) **Assess** the appropriateness of the audit procedures performed on related party transactions. (05 marks)
- (c) **Explain** the auditor's responsibility for identification of related party transactions. (03 marks)
- (d) **State** four(04) audit procedures that can be performed in reviewing the Events after the reporting period. (04 marks)

(B) The following matters relating to three audit clients have been submitted for the audit partner for pre-approval of respective audit reports:

Audit Client	Materiality (Rs.)	Issues Under Concern
A Ltd.	1 million	Significant non-compliance with SLFRS 15 – Revenue with contracts with customers and incorrect disclosure of incorrect revenue recognition policy. Cut off error in revenue. Both issues impact profit, inventory, sales and trade receivables which represent substantial proportion of the financial statements. Impact is significantly higher than the materiality.
B Ltd.	125,000	Not providing for a long outstanding debtor of Rs.150,000/- for which full provision would have been made.
C Ltd.	5.75 million	Total trade receivables amounting to Rs.7,768,000/- represents 5% of the total assets. No provision has been made for debtors' impairment. Debtors' aging report cannot be generated due to a system error. The auditor was unable to verify the appropriateness of not impairing debtors.

You are required to:

Assess the impact of the given issues on the opinion in the Independent Auditor's Reports of **A Ltd.**, **B Ltd.** and **C Ltd.** respectively.

(10 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.