



**ASSOCIATION OF ACCOUNTING TECHNICIANS
OF SRI LANKA**

CURRICULUM 2020

PILOT PAPER

Level III

**303 - FINANCIAL CONTROLS &
AUDIT (FCA)**

A publication of the Education and Training Division

**Association of Accounting Technicians
of Sri Lanka
303 - Financial Controls & Audit (FCA)**

Instructions to Candidates (Please Read Carefully)

Time Allowed:

Reading	:	15 Minutes
Writing	:	03 Hours

Structure of Question Paper:

- This paper consists of three Sections; Section A, Section B and Section C.
- All the questions of Section A, Section B and Section C should be answered.

Marks:

- Allocation of marks for each section:

Section	Marks
Section A	20
Section B	30
Section C	50
Total	100

- Marks for each question are shown with the question.
- The pass mark for this paper is 50%.

Answers:

- All answers should be written in the booklet provided, answers written on the question paper will not be considered for marking.
- Begin your answer of each question on a new page.
- All workings should be clearly shown.
- Do not write on the Margins.

Answer Booklets:

- Instructions are shown on the front cover of each answer booklet.

Calculators:

- Candidates may use any calculator except those with the facility for symbolic algebra and differentiation. No programmable calculators are allowed.

Attached:

- Action verb checklist – Each question will begin with an action verb (excluding OTQ's).
Candidates should answer the questions based on the definition of the verb given in the checklist.

Four Compulsory Questions

(Total – 20 marks)

SECTION A

Question 01

Niresh is an accounts trainee of a listed company in Sri Lanka. He heard that good corporate governance is imperative for listed entities.

Niresh needs to know the reason for the importance of good corporate governance for listed entities

You are required to:

- (a) **Explain** the importance of good corporate governance for listed entities. (03 marks)
- (b) **State** four (4) principles of Corporate Governance. (02 marks)
- (Total 05 marks)

Question 02

Risk management is an important part of business organizations and the objective of risk management is to identify and document the organization's risks in critical business processes and the internal controls within each process to mitigate those risks.

You are required to:

Explain two (02) techniques available to mitigate risks with an example for each. (05 marks)

Question 03

Rashmi read the following in a magazine:

"In the contemporary world, it is compulsory for business organizations to obtain independent assurance on a number of subject matters. Therefore, practitioners nowadays undertake a number of assurance engagements"

Rashmi raises the following questions:

- What is an 'assurance engagement'?
- What is the difference between 'reasonable assurance' and 'limited assurance'?

You are required to:

- (a) **Define** 'assurance engagement'. (02 marks)
- (b) **Explain** the difference between reasonable assurance and limited assurance. (03 marks)
- (Total 05 marks)

Question 04

N&A Associates is a firm of chartered accountants whose core activity is to provide assurance services. The firm is managed by a managing partner. The managing partner who manages the firm informed all partners and staff on the importance of implementing quality control procedures on engagements.

You are required to:

- (a) **Explain** the managing partner's responsibilities for quality within **N&A Associates**.
(03 marks)
- (b) **State** two (02) policies and procedures that need to be considered for quality control on individual engagements
(02 marks)
- (Total 05 marks)

End of Section A

Three (03) Compulsory Questions**SECTION B**

(Total – 30 marks)

Question 05

(A) Senuri is a newly joined trainee accountant in **Green (Pvt) Ltd. ("Green")** which provides professional gardening services. **Green** does not have any investments in other entities. **Senuri** was asked to coordinate with its statutory auditors in providing required details for the audit of **Green** for the year ended 31st December 2019.

Senuri has the following questions in her mind:

- Why are the auditors from outside the company?
- Why is professional judgment required to carry out the audit?

You are required to:

Explain the answers to the above questions to **Senuri**.

(04 marks)

(B) Senuri noted that the auditors have requested the following information:

- Draft financial statements for the year ended 31st December 2019.
- Approved budget for 2019.
- Internal audit reports issued by the internal auditor of **Green**.
- The present organization structure.

When **Senuri** inquired the audit senior about the purpose of all this information she was made to understand that these are essential for audit planning. **Senuri** also noted that the auditors spend time on documentation.

You are required to:

(a) Explain three (03) reasons for the importance of planning an audit of financial statements. **(03 marks)**

(b) Describe three (03) additional purposes of 'audit documentation' **(03 marks)**

(Total 10 marks)

Question 06

The statutory auditors of **Quick Cabs (Pvt) Ltd (“Quick”)** plan the audit of the financial statements of **Quick** for the year ended 31st December 2019.

The entity is a family owned business and the shareholders are the directors of **Quick**. **Quick** provides transportation services which are made available via a mobile application. Ten (10) staff are employed by **Quick** whilst a Chief Executive Officer (CEO) who is not a shareholder manages the operations of **Quick**. There are changes to the audit team except the audit partner compared to the audit team of the previous year.

You are required to:

- (a) **Describe** the risk assessment process that the auditors of **Quick** shall follow in respect of the audit of the financial statements for the year ended 31st December 2019. **(04 marks)**
 - (b) **Explain** three (03) risk assessment procedures the auditors of **Quick** need to perform to understand **Quick** and its environment, including its internal controls **(03 marks)**
 - (c) **Identify** three (03) risks of not detecting a material misstatement from fraud are higher than from error **(03 marks)**
- (Total 10 marks)**

Question 07

(A) **Rukmal** is an accountant at **Asia Air (Pvt) Ltd (“the company”)** which is a state-owned company. The company is presently under regulatory investigations due to reported misappropriation of the resources of the company.

- **Rukmal** has been requested to submit the business plan and budgets approved by the board of directors in respect of preceding years for the investigation purposes by the regulator.
- **Rukmal** has been requested by the board of directors to report the changes required to the financial reporting purposes with the adoption of new standards on Leases (SLFRS 16). However, **Rukmal** does not have a clear understanding of the new standard.

Rukmal has a doubt whether he will be breaching fundamental principles of code of ethics applicable for professional accountants by fulfilling these requests.

You are required to:

Assess whether **Rukmal** breaches the fundamental principles of code of ethics if he is adhering to the requests detailed in the scenario. **(04 marks)**

(B) Jayamini Perera who is employed as a partner at **Rathnayake & Co.**, an audit firm. She is the audit partner of **Galaxy (Pvt) Ltd. ("Galaxy")** since five (05) years. The board of directors of galaxy is impressed about her skills and invites her to be the Chief Finance Officer (CFO) of Galaxy as the position will be vacant within six (06) months due to the planned resignation of the current CFO. She has positively responded to the request and is now in the process of negotiating with the prospective employer. She will reach the final decision soon. The audit of the financial statements of **Galaxy** for the year ended 31st December 2019 is about to commence.

Jayamini is the audit partner of **Real Properties PLC ("Real")** for eight (08) years and she has been made eligible for 30% discount if she was to purchase a land which is being developed by **Real** as appreciation of her involvement in the audit of **Real**.

You are required to:

(a) Assess the threats **Jayamini** has faced to compliance with the fundamental principles of ethics. **(04 marks)**

(b) Explain two (02) firm wide safeguards **Rathnayake & Co.** may take to eliminate the threats or reduce them to an acceptable level. **(02 marks)**

(Total 10 marks)

End of Section B

Question 08

(A) Ready (Pvt) Ltd. manufactures steel products who entered the market recently. In the first few months it performed well in the market. Eventually the management has noted that there is a drop-in sale and the buyers have not satisfied with the quality of the products, and timing of delivery.

The Chief Executive Officer (CEO) noted that there are issues in the procurement process inventory process and the accounting system of the company.

Procurement process:

Presently the company purchases the materials from several suppliers. CEO directed that the company should have a supplier selection process for the main raw materials that are being used for the production. He emphasized that the company should buy the materials from these selected suppliers only.

As per the instructions from CEO, the procurement manager has identified a few suppliers and arranged for the newly formed procurement committee to evaluate these suppliers. Further he said it is important to formalize the procurement process in order to minimize the business risks in the procurement process.

Inventory Process:

The management of **Ready (Pvt) Ltd.** noted discrepancies in the physical quantities of inventories with the inventory records due to not recording the inventory issues. The production persons walk into the stores and take the inventories away for production. As a result, there are no source documents available to update the inventory records. The company operates (including the stores) in a leased building and it has allocated a significant area for keeping inventories. The management has realized the importance of having controls on inventory process of the company.

Accounting System:

The company uses an accounting system to record the transactions and generate sales invoices. The sales module is integrated to the general ledger of the company. The following issues were noted:

- In this system the sales are generated by the sales persons, finance persons of the company. They all use a common password to enter into the system.
- In the previous month the system malfunctioned for a day due to a virus attack to the system. However, there was no loss of data in the system.
- There were a few invoices generated not been recorded in the general ledger and there was a difference identified by the accountant of the company.

You are required to:

- (a) Explain** two (02) reasons why a supplier selection process is required to the company. **(04 marks)**
- (b) Identify** four (04) factors to be considered in evaluating the suppliers identified by the company. **(04 marks)**
- (c) Describe** four (04) business risks in the procurement process of the company. **(04 marks)**
- (d) Explain** two (2) weaknesses in the inventory process explained above and how to strengthen procedures to prevent each weakness. **(04 marks)**
- (e) Explain** three (03) reasons for implementing controls over inventory process of the company. **(03 marks)**
- (f) Discuss** the actions the management needs to take to address the accounting system issues noted above. **(06 marks)**

(Total 25 marks)

Question 09

(A) **Good Tyre (Pvt) Ltd. (“Good”)** is a tyre manufacturer who sells the products mainly via a dealer network and some products are directly sold to institutional customers. The dealers are provided credit period of 30 – 60 days. The debtors balances of Good as at 31st December 2019 and 31st December 2018 were as follows:

	2019 (Rs. million)	2018 (Rs. million)
Institutional debtors	50	55
Dealers	250	178
	300	233

The existence and valuation of debtors were the main focus of the auditors of **Good**. The audit team has performed the following procedures to address the risks relating to existence and valuation:

- Calling of confirmations from selected dealers.
- Testing the impairment on debtors.

The accountant has posted the following confirmation letter to six (06) debtors out of 114 debtors and these 06 debtors represent 2% of the total debtors’ balance as at 31st December 2019. The 06 debtors have been selected by a member of the audit team:

[Addressee

Address]

Date:

Dear Sir,

At the request of our auditor, we request that you kindly confirm your indebtedness to us which according to our records, amounted to Rs. ----- as shown by the enclosed statement.

If the above amount is in agreement with your records, please sign in the space provided below and return to us.

If the amount is not in agreement with your records, please provide full details of the difference.

Yours faithfully'

For Good Tyres (Pvt) Ltd.

Reference No. -----

.....

The amount shown above is / is not in agreement with our records

Signature of responsible person

None of the debtors has replied the confirmation requests.

You are required to:

- (a) Explain** two (02) weaknesses in the debtors' confirmation request process relating to the audit of **Good Tyres (Pvt) Ltd.** **(04 marks)**
- (b) Explain** two (02) alternative procedures the audit team shall perform to test the existence of debtors as at 31st December 2019. **(03 marks)**

(B) Silverline Apparels (Pvt) Ltd. ("Silverline") exports apparels. It purchases the materials from its related entities. Further, some of the work relating to apparel manufacturing are outsourced to the related entities. The audit partner instructed the audit team of **Silverline** to perform sufficient and appropriate audit procedures on related party transactions.

You are required to:

- (a) Explain** as the senior in charge on the party responsible to identify and disclose the related party transactions of **Silverline (Pvt) Ltd.** **(02 marks)**
- (b) Explain three** (03) reasons why the auditor may not be in a position to identify all related parties transactions **(03 marks)**
- (c) State** three (03) audit procedures the auditors of **Silverline** shall perform on related party transactions. **(03 marks)**

(Total 15 marks)

Question 10

M&B Associates was appointed as the statutory auditor of **Mega Traders (Pvt) Ltd.** (“**Mega Company**”) for the year ended 31st December 2019. The audit senior of **Mega** has brought the following to the attention of the audit partner and the manager:

- The bank reconciliation statements are not prepared for three (03) bank accounts maintained by **Mega**.
- Payments are made both in cash and by cheques. Sales are made both on cash and credit basis. There is no limit set for cash payments. The cash book does not reflect all the cash transactions (both payments and receipts) of **Mega** for the year ended 31st December 2019.
- The company does not maintain sufficient records on inventory purchased.
- There are no alternative procedures the audit team can perform to ensure completeness of cash transactions and purchases and there is a doubt about the completeness of sales, expenses and purchases of the company for the year ended 31st December 2019.

You are required to:

- (a) **Assess** the appropriateness of the suggested opinion on the financial statements of **Mega Traders (Pvt) Ltd.** for the year ended 31st December 2019. **(04 marks)**
- (b) **Explain** what is “emphasis of matter” paragraph in an auditor’s report. **(03 marks)**
- (c) **Explain** two (02) circumstances in which an emphasis of matter may be necessary in the auditor’s report **(03 marks)**
- (Total 10 marks)**

End of Section C

Action Verbs Check List

Analysis (4)	Draws Connections Among Ideas and Solve Problems	Analyze	Examine in details to find the solution or outcome
		Differentiate	Constitute a difference that distinguishes something
		Discuss	Examine in detail by arguments
		Compare	Examine to discover similarities
		Contrast	Examine to show differences
		Outline	Make a summary of significant features
		Communicate	Share or exchange information
Application (3)	Uses and Adapts Knowledge in New Situations	Apply	Put to practical use
		Calculate	Ascertain or reckon with mathematical computation
		Demonstrate	Prove or exhibit with examples
		Prepare	Make or get ready for particular purpose
		Solve	Find solutions through calculations and/or explanation
		Assess	Determine the value, nature, ability or quality
		Graph	Represent by graphs
		Reconcile	Make consistent/compatible with another
Comprehension (2)	Explains Ideas and Information	Define	Give the exact nature, scope or meaning
		Explain	Make a clear description in detail using relevant facts
		Describe	Write and communicate the key features
		Interpret	Translate in to understandable or familiar terms
		Recognize	Show validity or otherwise using knowledge or contextual experience
Knowledge (1)	Recall Facts and Basic Concepts	List	Write the connected items
		Identify	Recognize, establish or select after consideration
		State	Express details definitely or clearly
		Relate	Establish logical or causal connections
		Draw	Produce a picture or diagram
Level of competency	Description	Action Verbs	Verb Definitions



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SUGGESTED ANSWERS

Level III

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Answer to Question No 01**Unit 1 – Business Environment and Governance Framework**

Learning outcome – Identify key components of organization's governance framework and discuss the importance of corporate governance in achieving objective of an organization.

(a) In contrast to many private companies, the owners / shareholders of listed companies are different with management (board of directors). Therefore, there is a need that the shareholders do not remain in a disadvantaged position. In this context, there must be a good system with which these companies are directed and controlled. **[03 marks]**

- (b) - Keep the interest of Stakeholders in Mind.
- Treating Shareholders Equally.
- Identifying the roles of the Board of directors.
- Ethical Behavior.
- Transparency. **[½ mark each for four principles - 2 marks]**

Answer to Question No 02**Unit 2 – Risk Management Framework.**

Learning outcome – Identify techniques used in mitigating risks.

- (i) Risk avoidance – This is risk avoidance. It is considered whether risk can be avoided if so whether risk avoidance is desirable. **eg -:** Close down on existing loss making business unit.
- (ii) Risk acceptance – This is accepting the amount of risks, without need for further measures to treat the risk. **eg -:** Natural disaster.
- (iii) Risk transfer – Transferring risk to someone else who will be willing to accept a risk from someone in return for a payment or other benefits. **eg -:** Insurance from an insurance company
- (iv) Risk reduction – May decide that a risk should be reduced because it is currently too high and so unacceptable. **eg -:** Diversification of operations. **[1 mark each identifying 2 risks – 2 marks]**
[Explaining those 1 mark each – 2 marks]
[Examples ½ mark each – 1 mark]

Answer to Question No 03

Unit 4 – Assurance Engagement and Related services

Learning outcome – Explain the concept of assurance and difference between Reasonable Assurance and Limited Assurance.

- (a) An assurance engagement is an engagement in which a practitioner expresses an opinion or conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation of a subject matter against certain criteria [2 marks]
- (b) Reasonable assurance is a fairly high level of assurance but it is not 100% absolute assurance. In order to give a reasonable assurance, a significant of testing and evaluation is required. Limited assurance is a lower level of assurance than reasonable assurance. It allows for a lesser amount of testing and evaluations. [3 marks]

Answer to Question No 04

Unit 9 – Quality requirements for an audit of financial statements

Learning outcome – Explain quality control requirements applicable for an audit of financial statements.

- (a) **Leadership responsibilities for quality:**
- The managing partner is required to assume ultimate responsibility for the firm’s system of quality control.
 - He should inspire a quality culture within the firm and should spread this quality culture in their actions and messages, which also shall be embedded to the business strategy of the firm.
 - The managing partner shall appoint individual or group of individuals with appropriate experience, and authority to maintain quality within the firm.
- [1 mark each – 3 marks]
- (b) **Quality control on individual engagements:**
- Direction.
 - Supervision.
 - Review.
- [1 mark each for any two – 2 marks]

End of Section A

Three Compulsory Questions

(Total 30 marks)

SECTION B

Answer to Question No 05**Unit 5 – Risk assessment and audit process**

Learning outcomes – Explain overall objectives of independent auditor and conduct the audit in accordance with SLAuSs

– Explain planning the audit and audit documentation.

(A)

- (i) The objective of an audit is to enable the auditor to express an independent opinion on whether the financial statements are prepared, in all material aspects, in accordance with an applicable financial reporting framework. Therefore the audits shall be conducted by a firm / persons outside the company who are independent from Green. **[2 marks]**
- (ii) The auditor should exercise professional judgment in planning and performing an audit of financial statements. Professional judgment is required for,
- Materiality and audit risk.
 - Nature timing and extent of audit procedures.
 - Evaluation of whether sufficient appropriate audit evidence has been obtained.
 - Drawing conclusion based on audit evidence. **[2 marks]**

(B) (a) Importance of planning an audit of financial statements:

- The auditor shall provide reasonable assurance on the financial statements. For this it is important to know what are the important areas for which the auditor should give appropriate attention.
- With effective planning the auditor will be able to identify the problems and thereby resolve potential problems on a timely basis.
- By effectively planning, the auditor will be able to properly organize and manage the audit so the audit will be performed effectively.
- It will assist the selection of appropriate team members and assignment of work to them.
- It facilitates the direction, supervision and review of work as the planning involved identified important areas of the audit require special attention, the resources involved in the audit. **[1 mark each for any 3 points]**

(b) Additional purposes of audit documentation:

- Documentation will assist the engagement team to plan and perform the audit. The execution will be done as planned when the audit plan is documented with sufficient details.
- The reviewers will be able to review the work documented and facilitate supervision of the work performed by the engagement team.
- The documentation will provide evidence of the work performed which can be verified for the quality review purposes.
- The documented work can be carried forward for future reference and be part of important information for future audits.

[1 mark each for any 3 points]

(Total 10 marks)

Answer to Question No 06

Unit 5 – Risk assessment and audit process

- Learning outcomes – Define risk assessment procedures and explain the procedure used in risk assessment.
- Define fraud risk and explain auditor’s responsibility for preventing detecting fraud in an audit of financial statements.

(a) Risk assessment process:

1. Perform risk assessment procedures to obtain an understanding of the entity and its environment, including internal controls.
2. Identify business risks that may result in material misstatements in the financial statements as per the understanding obtained from (1) above.
3. Evaluate the entity’s responses to those business risks and obtain evidence of their implementation.
4. Assess the risk of material misstatements at the assertion level and determine the audit procedures that are necessary based on the risk assessment.

[1 mark each – 04 marks]

(b) Risk assessment procedures to understand Quick:

- Inquiries of management and of others within the entity: board of directors, CEO, employees, etc. This is to understand the environment within which the financial statements are prepared.
- Analytical procedures : risk assessment analytical procedures to be performed to understand the variances from the expectations to identify the areas / financial statement line items which require special attention of the auditor.
- Observations by the auditor – Looking at procedures or process being performed by others. E.g. how the bookings are recorded in the system.
- Inspection: Can inspect documents such as business plans and strategies, records and internal control manuals which is essential to obtain an understanding of the business and for the risk assessment process. **[1 mark each – 03 marks]**

(c) Fraud risks:

- Fraud may involve sophisticated schemes designed to conceal it.
- Fraud may be perpetrated by individuals by collusion.
- Management fraud is harder to detect because management is in a position to manipulate accounting records or override controls. **[3 marks]**

(Total 10 marks)

Answer to Question No 07

Unit 8 – Ethical Requirements

Learning outcome – Identify threats to compliance with the fundamental principles and evaluate the significance of the threats identified.

(A) (i) Business plan and budgets: These are considered to be confidential information of a business. As a professional accountant Rukaml has an obligation to refrain confidential information from disclosing outside the company. However, in this case the investigations are done by the regulator. Such disclosures are permitted and required by law. Therefore, by submitting the required details Rukmal will not breach the fundamental principle, ‘confidentiality’ **[2 marks]**

(ii) SLFRS 16: ‘Professional competence’ is a fundamental principle which is set out in the code of ethics for professional accountants. The members should refrain from undertaking assignment unless competent advice and assistance is obtained to enable them satisfactorily carry out the assignment. In this case if undertakes the task without informing the directors,

the required assistance / training he will be breaching the fundamental principle 'professional competence' [2 marks]

(B) (a) Threat to compliance with the fundamental principles:

Galaxy – The threat is Self-interest. [1 mark]

Jayamini is having an interest in Galaxy to secure her employment at Galaxy. She is presently the audit partner (as the scenario does not indicate whether she has stepped down) and her independence will be impaired as the audit partner if he continues to be the audit partner despite of the present employment negotiations she is having with the audit client. [1 mark]

Real property – She has had a long relationship with her listed audit client. **Jayamini** has been exposed to "Familiarity" threat due to the long association with the listed audit client which has resulted in offering a lucrative and material financial benefit. As a result of the long association she may be sympathetic to the client's interests. [2 marks]

(b) Safeguards:

- Firmwide policies and procedures to be developed on accepting employment of audit clients. This should address the procedures to follow when an offer is made by an audit client to join for an audit partner or audit staff. This includes whom to be informed, when to be informed, what approvals are required. What the firm will take to address the threat identified (e.g. not to be involved in the audit anymore as a partner or team member).
- Firmwide on rotation of the partner, key staff. The rotation period may be defined for listed entities and non-listed entities.
- Firmwide policy to be introduced on accepting gifts / benefits from audit client. What is the value limit, and the process to follow when materially significant gift is offered.

[1 mark each for any two - 2 marks]

(Total 10 marks)

End of Section B

Answer to Question No 08**Unit 3 – Internal Control System and Business Processes**

Learning outcomes - Discuss each business processes in business organizations.
- Analyse adequacy of processes and controls in IT and recommended improvements.

(A)**(a) Supplier selection:**

- (i) Costs increase if the company purchases materials from various suppliers and the company will be unable to negotiate prices effectively and may forego bulk discounts.
- (ii) The company may not have a guarantee on the reliability of the supplier, whether the suppliers will be able to supply the required quantities at the right time.
- (iii) There could be delayed if the suppliers are from distant locations, and as a result production will be interrupted. **[2 marks each - 4 marks]**

(b) Supplier evaluation:

- Is the supplier reliable?
- Does it have the capability to supply goods in the quantities required?
- Is the supplier financially stable?
- Is there a risk that the supplier will become insolvent?
- Can the supplier deliver goods to the quality standard required?

[1 mark each, maximum 4 points]

(c) Business risks in the procurement process:

- Supplier is unable to provide the goods, or cannot provide goods to the required quantity.
- The company may order the goods which may not be required.
- Goods will be purchased at an excessive price if the suppliers are not correctly identified / negotiated.
- The supplier may not deliver the goods on time and or will be delivered in bad condition which have an impact of the quality of the production.
- Supplier may submit an invoice for an incorrect amount or for goods that have not been delivered to the company. This will result in company incurring additional costs, if not detected.
- Supplier may deliver more / less goods than ordered which will either have an additional cost to the company or interruption to the production plan of the company.

[1 mark each, maximum of 4 points]

(d) Controls on issuing materials:

- The stores shall not issue inventories unless it is supported with an authorized request. For this purpose MRN which is approved by an authorized officer shall be used.
- All the material issues shall be supported with MIN, which shall be acknowledged by a responsible person at the receipt of the materials and issue noted shall also consist of a serial number.

[2 marks each - 4 marks]

(e) Controls over inventory process:

- The company has to incur costs on holding inventories. Therefore, a control should be in place to ensure the company orders and stores the inventory items which are essential / required to meet the production plan.
- The controls should be in place to order the inventories at the right time to avoid any production stoppages which may result of not having adequate inventory.
- Quality of the raw material is critical for the quality of the production. Therefore, need to have controls in place to identify quality issues, defects of the materials delivered by the suppliers and expiring items shall be managed effectively.

[1 mark each - 3 marks]

(f) System weaknesses:

Weakness	Recommendation / actions
In this system the sales are generated by the sales persons, finance persons of the company. They all use a common password to enter into the system.	There should be segregation of duties in generating the invoices. The invoicing module shall be restricted and it shall be password protected.
In the previous month the system was malfunctioned for a day due to a virus attack to the system.	Anti-virus software shall be installed and updated. In order to avoid future data losses, back up procedures to be stringently implemented.
There were a few invoices generated have not been recorded in the general ledger and there was a difference identified by the accountant of the company.	The system shall be programmed to trigger exceptions. The system can be developed to run an exception report rather performing manual reconciliations. [Auto calculations of totals, cross checking – is an acceptable answer]

[2 marks each – maximum 6 marks]

(Total 25 marks)

Answer to Question No 9

Unit 6 – Audit Evidence

- Learning outcomes - Discuss the procedures used in obtaining audit evidence.
- Assess risk associated with related party transactions.

(A) (a) Weaknesses in the confirmation process:

- (i) Sample selection of 6 – the rationale cannot be understood. Why 6 as the existence being one of the focus areas relating to debtors.
- (ii) Confirmation requests have not been under the control of the auditor. Those are directly sent by the client.
- (iii) The confirmation request does not include sufficient details, the date on which the balances to be confirmed by the dealer / debtor, it does not indicate that the replies shall be directly sent to the auditor including any differences.
- (iv) There is no evidence of follow up procedures on the request made.

[2 marks each – 4 marks]

(b) Alternative procedures:

- Select a representative sample to address the risk identified on debtors' existence and check for subsequent settlements.
- If no subsequent settlements were noted, check for the supporting documents, evidence of sale of goods, acceptance of goods.
- Select a sample of dealers / debtors, obtain their contact details and directly call them to get confirm the balance. **[1.5 marks each, maximum of 3]**

(B)

(a) The management of Silver Apparels (Pvt) Ltd is responsible for the identification of related party transactions and the management is also responsible for the disclosing the related party transactions in the financial statements **[2 marks]**

(b) The auditor may not in a position to identify all related parties and transactions due to following reasons:

- Related party transactions have taken place without a charge
- Related party transactions are not self-evident to the auditors
- Transactions are with a party that the auditors could not reasonably be expected to know is a related party
- Active steps have been taken by management to conceal either the full terms of a transaction, or that a transaction is, in substance, with a related party
- The corporate structure is complex. **[1 mark for each point, maximum of 3 points]**

(c) Audit procedures to follow on related party transactions:

- Enquire of management and the directors as to whether transactions have taken place with related parties that are required to be disclosed in the financial statements.
- Review prior-year working papers for names of known related parties.
- Review of minutes of meetings of shareholders and directors and other relevant statutory records such as the register of directors' interests.
- Review of accounting records for large or unusual transactions or balances, in particular transactions recognized at, or near, the end of the financial period.
- Review confirmations of loans receivable and payable and confirmations from banks. Such a review may indicate the relationship, if any, of guarantors to the entity.
- Enquire as to the names of all pension and other trusts established for the benefit of employees and the names of their management and trustees.
- Enquire as to the affiliation of directors and officers with other entities.

[1 mark each maximum of 3 points]

(Total 15 marks)

Answer to Question No 10

Unit 7 – Audit Reporting.

Learning outcomes - Assess modifications to the opinion in the independent auditor's report

- Explain use of Emphasis of Matter paragraph

(a) Appropriateness of the audit opinion:

- The audit senior has suggested a qualified opinion considering the limitation of scope in ensuring the completeness of sales, purchases and expenses of **Mega Traders (Pvt) Ltd.** for the year ended 31st December 2019 as there are no alternative procedures to be performed. [2 marks]
- However, as per the given facts in the scenario this scope *limitation has a pervasive impact on the financial statements* of **Mega Traders (Pvt) Ltd.** as it affects many financial statement line items, basically the entire income statement or comprehensive income for the year ended 31st December 2019. [01 mark]
- Due to the pervasive impact, the auditor shall disclaim its opinion on the financial statements of **Mega Traders (Pvt) Ltd.** for the year ended 31st December 2019. [01 mark]

(b) Emphasis of matter:

Auditor includes an emphasis of matter paragraph in the audit report when the auditor decides users of the audited financial statements should pay attention to a specific matter appropriately disclosed or presented in the financial statements that in the auditor's judgment, the particular matter is fundamental to user's understanding of the financial statements.

Inclusion of emphasis of matter paragraph does not affect the auditor's opinion. [3 marks]

(c) Circumstances in which emphasis of matter may be necessary:

- Existence of an uncertainty relating to a future outcome of an exceptional litigation or regulatory action
- Early application of a new accounting standard that has a pervasive effect on the financial statements.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

[1 1/2 marks each, maximum of 3 marks]

(Total 10 marks)

End of Section C