



**Association of Accounting Technicians of Sri Lanka**

**Level III Examination – January 2023**

**Suggested Answers**

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

**Association of Accounting Technicians of Sri Lanka**

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(Total 20 Marks)

SECTION - A

*Suggested Answers to Question One:*

*Chapter 01- Business Environment and Governance Framework*

(a)

I do not agree

Agency theory defines the relationship between principals, the shareholders and agents, the directors. According to agency theory when the principal employs another party i.e agent to perform a task on his behalf, then the Agency relationship occurs.

However, stewardship is the responsibility to take good care of resources of the organization.

(03 marks)

(b)

Fiduciary relationship occurs when one person has a duty of care towards someone else. The relationship of 'good faith' can be seen between the directors of a company and the shareholders of the company.

(02 marks)

(Total 05 marks)

*Suggested Answers to Question Two:*

*Chapter 02 - Risk Management Framework*

(a)

	Risk	Type of Risk	Techniques of managing the risk
(1)	Unexpected breakdown in machinery	Operational risk	Risk transfer
(2)	Intentionally presenting inaccurate information in the financial statements	Fraud Risk	Risk reduction
(3)	Employee fails to work according to established procedures of the organization	Compliance Risk	Risk reduction

(4)	Selling products which are poor in quality	Reputational risk	Risk reduction
(5)	Rapid increase in interest rates	Operational risk/ External risk	Risk reduction

(05 marks)

### ***Suggested Answers to Question Three:***

#### ***Chapter 04 - Risk Management Framework***

<b><i>Role</i></b>	<b><i>Relationship</i></b>
Responsible party – provides the information for the benefit of relevant uses. The party is responsible for subject matter.	Users – use the information provided by the responsible party to make decision Practitioner – Uses the information to provide an assurance on such information
Practitioner - Engaged to perform an assurance engagement in relation to the subject matter information. That the responsible party is responsible for.	Responsible party - Provides the information relating to the subject matter. Users- Use the report issues by the practitioner to make decisions.
Intended user – the recipient of the services, assets or information	Responsible party - Provides the information to the users. Users - Affected by the activities of the responsible party. Practitioner - Performs the assurance engagement in relation to the users (all users or may be restricted to specific users)

(05 marks)

### ***Suggested Answers to Question Four:***

#### ***Chapter 09 - Risk Management Framework***

##### **(a) Leadership Responsibilities for Quality within the firm**

The firm shall establish policies and procedures designed to promote an internal culture recognizing that quality is essential in performing engagements. Such policies and procedures shall require the firm's chief executive officer (or equivalent) or, if appropriate, the firm's managing board of partners (or equivalent) to assume ultimate responsibility for the firm's system of quality control.

The firm's leadership and the examples it sets significantly influence the internal culture of the firm. The promotion of a quality-oriented internal culture depends on clear, consistent and frequent actions and messages from all levels of the firm's management that emphasize the firm's quality control policies and procedures.

(03 marks)

**(b)**

a) Tracking the progress of the engagement.

b) Considering the competence and capabilities of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions and whether the work is being carried out in accordance with the planned approach to the engagement.

c) Addressing significant matters arising during the engagement, considering their significance and modifying the planned approach appropriately.

d) Identifying matters for consultation or consideration by more experienced engagement team members during the engagement.

**(02 marks)**  
**(Total 05 marks)**



**End of Section A**

*Suggested Answers to Question Five:*

**Chapter 05 - Risk Assessment and Audit Process**

(a)

- 1 Helping the auditor to devote appropriate attention to important areas of the audit.
- 2 Helping the auditor to identify and resolve potential problems on a timely basis.
- 3 Helping the auditor to properly organize and manage the audit engagement so that it is performed in an effective manner.
- 4 Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks and the proper assignment of work to them.
- 5 Facilitating the direction and supervision of engagement team members and the review of their work.
- 6 Assisting in coordination of work done by auditors of components and experts.

**(03 marks)**

**Chapter 05 - Risk Assessment and Audit Process**

(b)

1. Relevant industry, regulatory and other external factors including the applicable financial reporting framework affecting the company.
2. The nature of the entity, including its operations, its ownership and governance structure (e.g. who are the shareholders of Star Lanka and such %, any loans obtained to finance the activities etc.)
3. The types of investments that the entity is making and plans to make, including investments in special purpose entities.
4. The way the entity is structured and how it is financed (Type of the dealership - whether they are consignment agents or not) (Stocks balances with dealers and their values etc. how accounted in books)
5. The entity's selection and application of accounting policies, (Credit period to dealers, Credit period to retail customers, outstanding handling etc.) including its appropriateness and consistency in the business and industry.

6. The entity's objectives and strategies and those related business risks that may result in risks of material misstatement. (Manufacturing account, costing and sales prices to dealers, retail prices, free issuing to customers, Discount structures etc.)

7. The measurement and review of the entity's financial performances.

**(03 marks)**

**(c)**

1. Performing procedures regarding the continuance of the client relationship and the specific audit engagement to ensure there are no issues with management integrity that may affect the auditor's willingness to continue the engagement.

2. Evaluating compliance with relevant ethical requirements including independence to ensure the auditor maintains the necessary independence and ability to perform the engagement.

3. Establishing an understanding of the term of the engagement to ensure that there is no misunderstanding with the client as to the terms of the engagement.

**(04 marks)**

**(Total 10 marks)**

### ***Suggested Answers to Question Six:***

#### ***Chapter 05 - Risk Assessment and Audit Process***

**(a)**

The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

An auditor conducting audit in accordance with SLAuS is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Due to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements due to fraud may not be detected and the potential effects are significantly high in this case of misstatements than a material misstatement due to an error. This is because a fraud may involve sophisticated and carefully organized scheme designed to conceal it. Further, the fraud may be perpetrated by individuals by collusion. Frauds committed by the management are harder to detect because management is in a position to manipulate accounting records or override controls. Therefore, the Auditor should perform adequate audit procedures to reduce the risk.

**(04 marks)**

(b)

- Identify risk of material misstatement of the financial statements due to fraud
- Obtain sufficient appropriate audit evidence regarding the assessed risk of material misstatement due to fraud, through designing and implementing appropriate responses.
- Respond appropriately to fraud or suspected fraud identified during the audit.

(02 marks)

(c)

Communication Area	Details
The Auditor's Responsibilities in Relation to the Financial Statement Audit	The auditor shall communicate with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, including that the auditor is responsible for forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance.
Planned Scope and Timing of the Audit	The auditor shall communicate with those charged with governance an overview of the planned scope and timing of the audit.
Significant Findings from the Audit	The auditor shall communicate with those charged with governance: <ul style="list-style-type: none"><li>▪ The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.</li><li>▪ Significant difficulties, if any, encountered during the audit</li><li>▪ Unless all of those charged with governance are involved in managing the entity:<ul style="list-style-type: none"><li>○ Significant matters, if any, arising from the audit that were discussed, or subject to correspondence with management</li><li>○ Written representations the auditor is requesting</li></ul></li><li>▪ Other matters, if any, arising from the audit that, in the auditor's professional judgment, is significant to the oversight of the financial reporting process.</li></ul>
Auditor Independence	In the case of listed entities, the auditor shall communicate with those charged with governance: <ul style="list-style-type: none"><li>▪ A statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with relevant ethical requirements regarding independence.</li><li>▪ All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgment, may reasonably be thought to bear on</li></ul>

	<p>independence. This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity. These fees shall be allocated to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor.</p> <ul style="list-style-type: none"> <li>▪ The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.</li> </ul>
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**(04 marks)**  
**(Total 10 marks)**

### ***Suggested Answers to Question Seven:***

<b><i>Chapter 08 - Ethical Requirements</i></b>
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**(a)**

1. It is required to ensure whether than RPLC has adequate resources and competencies to conduct the audit since it is a large scale life insurance company.
2. The credibility of the financial statements along with the policies used by the company since the previous year audited financial statements have been re-issued due to a significant error correction.
3. A letter of warning has been issued by the Sri Lanka Accounting & Auditing Standards Monitoring Board, this indicates dishonesty and lack of integrity.
4. The net profit margin of the company is very high when compared with the other similar life insurance companies.

**(06 marks)**

**(b)**

- 1 Obtaining knowledge and understanding of the client, its owners, managers and those responsible for its governance and business activities.
- 2 Securing the client's commitment to address the questionable issues, for example, through improving corporate governance practices or internal controls.
- 3 Acquiring an appropriate understanding of the nature of the client's business, the complexity of its operations, the specific requirements of the engagement and the purpose, nature and scope of the work to be performed.
- 4 Acquiring knowledge of relevant industries or subject matters.
- 5 Possessing or obtaining experience with relevant regulatory or reporting requirements.



- 6 Assigning sufficient staff with the necessary competencies.
- 7 Using experts where necessary.
- 8 Agreeing on a realistic time frame for the performance of the engagement.
- 9 Complying with quality control policies and procedures designed to provide reasonable assurance that specific engagements are accepted only when they can be performed competently.

*(04 marks)*

*(Total 10 marks)*



*End of Section B*

***Suggested Answers to Question Eight:***

***Chapter 05 - Risk Assessment and Audit Process***

(a)

1. Dr.Roshan handles entire inventory process including checking the stock balance and placing the orders.
2. All GRNs are entered to the system by Kalpani who has no knowledge on the accounting.
3. All supplier selection, placing orders and cheques writing are done by Dr. Roshan.
4. Cashier himself make the deposits to the bank.
5. Dr.Roshan has no capacity to handle the business with the increased business activities
6. Banking the money in CDM deposit machines.
7. Coins collection from total collection are kept in a separate drawer without banking.

**(04 marks)**

(b)

***Chapter 03 - Internal Control System and Business Processes***

- A system of internal control system refers to processes introduced by management to help the organizations to accomplish its objectives and goals. Internal controls specify how organizations resources should be directed, controlled and measured. As a result, it plays an important role in preventing and detecting frauds and protecting the organizations resources.
- Any entity, irrespective of their size and nature of the operations, requires internal controls. When the organization's operations are complicated, a more sophisticated internal control system is required.

**(04 marks)**

(c)

***Chapter 03 - Internal Control System and Business Processes***

- 1 Communication and enforcement of integrity and ethical values
- 2 Commitment to competence
- 3 Participation by those charged with governance
- 4 Management's philosophy and operating cycle
- 5 Organization structure
- 6 Assignment of Authority and responsibility
- 7 Human resources policies and practices

**(05 marks)**

(d)

### **Chapter 03 - Internal Control System and Business Processes**

#### **1 Procurement Process**

The procurement process is the process of purchasing goods from suppliers, receiving goods and paying for them. Process is mainly consists of supplier selection, placing orders, receiving goods and paying for them.

#### **2 Payroll Process**

Main objective of a payroll system is to ensure that employees are paid for their work. Further it has another objective of avoiding under payments and over payments of salaries. Below steps can be seen in the payroll system.

#### **3 Cash Management Process**

Cash management is a high-risk area within an organization due to possible frauds and theft of cash. Therefore, every business organization should take necessary steps to ensure that, adequate security measures are taken over, cash in hand, completeness of recording cash receipts and payments are done only for genuine payments.

#### **4 Inventory Management Process**

Trading organizations and manufacturing organizations normally hold large volume of inventory; therefore, they have invested considerable amount of funds in inventory. To manage working capital effectively, inventory holding cost should be managed properly. Classification of inventories;

- Raw materials and components
- Work in progress
- Spare parts / consumables
- Finished goods

#### **5 Fixed Assets Process**

PPE are the non-current assets that are acquired and used in the business organization to earn profits and income over a period of several years or its administrative purposes. Fixed asset management is the process of tracking and maintaining an organization's physical assets and equipment. Asset types include vehicles, computers, furniture and machinery. Using an asset management system, organizations can: Track and monitor fixed assets.

#### **6 Revenue Process**

This involves all activities directly associated with selling products or services. Revenue controls are perhaps the most important component of an organization's overall internal control framework.

**(06 Marks)**

**Chapter 03 - Internal Control System and Business Processes**

(e)

Application Control	Example
Controls over input completeness	<ul style="list-style-type: none"> <li>▪ Manual and programmed agreement of control totals</li> <li>▪ Document count</li> <li>▪ One-for-one checking of processed output to source documents</li> <li>▪ Programmed matching of input to an expected input controls file</li> <li>▪ Procedures over resubmission of rejected items</li> </ul>
Controls over input accuracy	<ul style="list-style-type: none"> <li>▪ Programs to check data fields (For example value, reference number, date) on input transaction for plausibility.</li> <li>▪ Digital verification                             <ul style="list-style-type: none"> <li>o Reasonable test</li> <li>o Character test</li> <li>o Existence test</li> <li>o Necessary Information</li> <li>o Permitted Range</li> </ul> </li> <li>▪ Manual scrutiny of output and reconciliation to source</li> <li>▪ Agreement of control totals</li> </ul>
Controls over Input authorization	<ul style="list-style-type: none"> <li>▪ Manual checks to ensure information input is authorized</li> <li>▪ Input by authorized personnel</li> </ul>
Controls over processing	<ul style="list-style-type: none"> <li>▪ Similar controls to input must be in place when input is completed. (Ex, Batch reconciliation)</li> <li>▪ Screen warnings can prevent people logging out before processing is complete</li> </ul>
Controls over master files and standing data	<ul style="list-style-type: none"> <li>▪ One-to-one checking</li> <li>▪ Cyclical reviews of all master files and standing data</li> <li>▪ Record counts (No of documentation processed) and hash totals (For example, the total of all the payroll numbers) used when master files are used to ensure no deletions</li> <li>▪ Controls over the deletion of accounts that have no current balance</li> </ul>

(06 marks)  
(Total 25 marks)

## Suggested Answers to Question Nine:

### Chapter 06 – Audit Evidences

(a)

Audit Procedure	Example
Inspection	<ul style="list-style-type: none"> <li>• Inspection of a bank statement confirms the bank balance shown in the bank reconciliation which intern confirms the cash book figure for the financial statements</li> <li>• Inspection of a loan agreement to confirm the terms and repayment details</li> <li>• Inspection of sales invoices to ensure the correct customer has been invoiced and correct amounts have been taken into books of accounts</li> <li>• Inspection of title deed of a land belonging to a business organization.</li> </ul>
Observation	<ul style="list-style-type: none"> <li>• Observe physical stock verification</li> <li>• Observe internal control system of an entity to determine effective application of those controls</li> </ul>
Recalculation	<ul style="list-style-type: none"> <li>• Recalculation consists of checking the mathematical accuracy of do records.</li> <li>• Recalculation may be performed manually or electronically.</li> </ul>
Re-performance	<ul style="list-style-type: none"> <li>• Re performance of Bank reconciliations</li> <li>• Re performance of reconciliations between individual supplier balances with supplier statements</li> <li>• Reconciliation of debtors' sub ledger accounts with control ledger account</li> </ul>
Inquiry	<ul style="list-style-type: none"> <li>• Inquiry includes obtaining responses to formal written questions and informal questions in relating to specific audit assertions.</li> </ul>
Analytical Procedures	<p>Analytical procedures include the comparison of the entity's financial information such as revenue and expenses with</p> <ul style="list-style-type: none"> <li>• Comparable information for prior periods</li> <li>• Anticipated results such as budgets and forecasts</li> <li>• Similar industry information</li> </ul>

(06 marks)

**Chapter 06 – Audit Evidences**

**(b)**

A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative confirmations provide less persuasive audit evidence than positive confirmations.

**(02 marks)**

**Chapter 06 – Audit Evidences**

**(c)**

- Industry information such as comparison with industry averages
- Anticipated results of the entity such as budgets and forecasts, auditor's expectations etc.
- Comparable information with previous period
- Calculation of key ratios and compare those with the standard/ expectations (could benchmark with industry)

**(02 Marks)**

**Chapter 06 – Audit Evidences**

**(d)**

**Financial Indicators**

- Net liability or net current liability position
- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment
- Indications of withdrawal of financial support by creditors
- Negative operating cash flows (historical or prospective)
- Adverse key financial ratios
- Substantial operating losses or significant deterioration in the value of assets used to generate cash flows
- Arrears or discontinuance of dividends
- Inability to pay creditors on due dates
- Inability to comply with terms of loan agreements
- Change from credit to cash-on-delivery transactions with suppliers
- Inability to obtain financing for essential new product development or other essential Investments

### Operating Indicators

- Management intentions to liquidate or cease operations
- Loss of key management without replacement
- Loss of a major market, key customers, licence, or principal suppliers
- Labour difficulties
- Shortages of important supplies
- Emergence of a highly successful competitor

### Other Indicators

- Non-compliance with capital or other statutory requirements
- pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy
- changes in laws/regulations/government policy expected to adversely affect the entity
- Uninsured or underinsured catastrophes when they occur

*(05 marks)*

## **Chapter 07 - Audit Reporting**

### **(e) Auditor's report**

- (1) Emphasis of matter para cannot be used.
- (2) The auditor has decided that use of going concern assumption is not appropriate and presenting FSs on such basis will result in a modified audit opinion.

*(04 marks)*

### **(f)**

1. Qualified opinion cannot be issued.
2. When there is a situation where the matter gives rise to the modification is material but not pervasive, then a qualified opinion can be issued. In this scenario, we have decided the impacts from misstatements identified are not only material but pervasive as well.
3. Accordingly an adverse opinion has to be issued since the matter is both material and pervasive to the overall financial statements.

*(06 marks)*

*(Total 25 marks)*

***Notice:***

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