



Association of Accounting Technicians of Sri Lanka

Level III Examination – July 2023

Suggested Answers

(303) FINANCIAL CONTROLS & AUDIT (FCA)

Association of Accounting Technicians of Sri Lanka

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A publication of the Education and Training Division

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(303) FINANCIAL CONTROLS & AUDIT

SUGGESTED ANSWERS

(Total 20 Marks)

SECTION - A

Suggested Answers to Question One:

Chapter 01- Business Environment and Governance Framework

(a) (Writing any two of the below functions would permit full marks)

- 1 Overseeing the preparation, presentation, and adequacy of disclosures in the financial statements of Trust PLC in accordance with Sri Lanka Accounting Standards.
- 2 Overseeing compliance with financial reporting requirements, information requirements of the Companies Act, and other relevant financial reporting-related regulations and requirements of the **Trust PLC**.
- 3 Overseeing the process to ensure that the **Trust PLC's** internal controls and risk management are adequate to meet the requirements of the Sri Lanka Accounting Standards.
- 4 Assessment of the independence and performance of **Trust PLC's** external auditors.
- 5 To make recommendations to the board pertaining to the appointment, re-appointment, and removal of the external auditors
- 6 To approve the remuneration and terms of engagement of the external auditors.

(03 marks)

(b) (Writing any two of the below benefits would permit full marks)

- 1 Improve the quality of financial reporting, by reviewing the financial statements on behalf of the Board
- 2 Create a climate of discipline and a stronger environment control which will reduce the opportunity for fraud.
- 3 Strengthen the position of the external auditor by providing a channel of communication and forum for issues of concern

- 4 Provide a framework within which the external auditor can assert their independence in the event of a dispute with management
- 5 Strengthen the position of the internal audit function, by providing a greater degree of independence from management
- 6 Increase public confidence in the credibility and objectivity of financial statements since audit committee monitors the independence of external auditors through audit opinion.

(02 marks)
(Total 05 marks)

Suggested Answers to Question Two:

Chapter 02 - Risk Management Framework

	Risk	Techniques that can be used for mitigating risk
(1)	Carrying a considerable amount of money to deposit in the bank.	<p>Risk Transfer: Risk transfer is a risk management and control strategy that involves the contractual shifting/transferring of a pure risk from one party to another.</p> <p>Action: Getting an Insurance plan to cover the risk of losing cash.</p>
(2)	Continued losses of the restaurant of Glenrock , which was at a separate location.	<p>Risk Avoidance: Risk avoidance is the elimination of hazards, activities and exposures that can negatively affect an organization's assets. Whereas risk management aims to control the damages and financial consequences of threatening events, risk avoidance seeks to avoid compromising events entirely</p> <p>Action: close down loss-making restaurant</p>
(3)	The hotel industry is a vulnerable industry in Sri Lanka now	<p>Risk Reduction: Management may decide that a risk should be reduced because it is currently too high and so unacceptable. Methods of reducing the risk depend on the nature of the risk.</p> <p>Action : Diversification of operations</p>

(05 marks)

Suggested Answers to Question Three:

Chapter 04 – Assurance Engagements and Related Services

(Explaining any two of the below would permit full marks)

1. Ethical & Quality Control requirements

The practitioner should comply with quality control requirements and Code of Ethics of applicable to professional accountants.

2. Engagement Acceptance and Continuance

The practitioner should consider the subject matter, responsible party, and intended users and the practitioner should be a professional person.

3. Planning and Performing Engagement

The practitioner should plan the engagement and consider terms, subject matter, criteria, evidence using experts, etc.

4. Assessing the appropriateness of the subject matter

The subject matter should be identifiable, can be evaluated against the criteria and sufficient and appropriate audit evidence can be obtained regarding the subject matter.

5. Assessing the suitability of the criteria

The practitioner should have preliminary knowledge of the engagement, and that the criteria to be used are suitable.

6. Materiality and assurance engagement Risk

The practitioner should consider materiality assurance engagement risk when planning and performing an assurance engagement.

7. Obtaining Evidence

The practitioner should obtain sufficient appropriate evidence on which to base the conclusion.

8. Documentation

The practitioner should document matters that are significant in providing evidence that support the assurance report and that the engagement was performed in accordance with SLSAE.

9. Preparing the assurance report

The practitioner should conclude whether sufficient appropriate evidence has been obtained to support the conclusion expressed in the assurance report.

The assurance report should be in writing and should contain a clear expression of the practitioner's conclusion about the subject matter information.

(05 marks)

Suggested Answers to Question Four:

Chapter 09 – Requirements for an Audit of Financial Statements

(Explaining any two of the below would permit full marks)

1 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. The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality of each audit engagement, is crucial.

2 Relevant ethical requirements

The firm shall establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements, which include: Integrity, Objectivity, Professional competence, Due care, Confidentiality, Professional behavior.

3 Acceptance and continuance of client relationships and specific engagements

Such policies and procedures are designed to provide the firm with reasonable assurance that it will only undertake or continue relationships and engagements where the firm

- a) Is competent to perform the engagement and has the capabilities, including time and resources, to do so,
- b) Can comply with relevant ethical requirements,
- c) Has considered the integrity of the client and does not have information that would lead it to conclude that the client lacks integrity.

4 Human resources

The firm shall assign responsibility for each engagement to an engagement partner and shall establish policies and procedures for human resources management.

5 Engagement performance

The policies and procedures for this area shall include,

- a) Matters relevant to promoting consistency in the quality of engagement performance through performing introduce with professional standard, applicable legal regulatory requirement.
- b) Supervision responsibilities
- c) Review responsibilities

6 Monitoring

The firm shall establish a monitoring process design to provide reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively.

(05 marks)



End of Section A

Suggested Answers to Question Five:

Chapter 03 / 07 - Business Processes / Audit Reporting

(a)

Inventory represents approximately 74% of the total assets and over 91% of the net assets of Intel, which is considered as material and pervasive.

The management of the company has not stated the inventory at the lowest of the cost or Net Realizable Value, as a result, the value of the inventory would be over-valued, which contradicts LKAS 02. Physical inventory verification is to be done to obtain comfort over existence of inventories. Therefore, unless the management agree to value inventories at lower of cost and NRV it is advisable for the auditor to express a qualified opinion. Also since the auditor is not invited for the physical verification, need to assess whether alternative procedures are possible to perform to obtain comfort over existence of inventories as at 31st march 2023. If not, this would result in a qualified opinion.

Auditor shall express a qualified opinion when, the auditor having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements.

(03 marks)

(b) The following matters need to be considered in forming the auditor's opinion.

(Stating any four of the below would permit full marks)

- 1 Whether sufficient appropriate audit evidence has been obtained.
- 2 Whether identified uncorrected misstatements are material individually or in aggregate to the financial statements.
- 3 The financial statements appropriately disclose the significant accounting policies selected and applied.
- 4 Whether the accounting policies selected and applied are consistent with the applicable financial reporting framework.
- 5 Whether the accounting estimates made by management are reasonable.
- 6 Whether the information presented in the financial statements is relevant, comparable, and understandable.

- 7 Whether the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events.
- 8 Whether terminology used in the financial statements including the title of each financial statement is appropriate.
- 9 Whether the financial statements achieve fair presentation

(04 marks)
(Total 10 marks)

Suggested Answers to Question Six:

Chapter 08 – Ethical Requirement

(a)

- 1 Before accepting **Good Bank PLC** as a client, **R & F** should determine whether acceptance would create any threats to compliance with the fundamental principles.
- 2 Here we can identify that the company has not made provision for impairment relating to loans and advances.
- 3 **R & F** should evaluate the significance of this matter and should apply relevant safeguards to reduce the risk to an acceptable level.
- 4 The firm can reduce the risk and accept the client by using experts to evaluate financial assets and impairments.
- 5 Assigning sufficient staff with relevant experience.
- 6 Possessing experience with relevant reporting requirements.

Then the firm can accept **Good Bank PLC** as a new client

However if it is not possible to reduce the threats to an acceptable level, the auditor shall decline to enter into the client relationship.

(05 marks)

(b)

- **Centra PLC** is a public company so in the case of audit engagements, it is in the public interest and therefore it is required by the Code, that the engagement partner, the team, and the firm shall be independent of **Centra PLC**.
- Independence comprises independence in mind and independence in appearance.
 - Independence of mind – The state of mind permits the expression of conclusion without being affected by influences that compromise professional judgment,

thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

- Independence in appearance – The avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a partner’s integrity, objectivity or professional skepticism has been compromised.
- There are some circumstances and relationships that can be recognized as possible threats to independence such as financial interest, loans and guarantees, business relationships, and family and personal relationships.
- In this question we can identify a close relationship, and senior personnel having a long association with the assurance client. Partner associating too much with a client in public may lead to the independence being questioned since independence in appearance has not been maintained.

(05 marks)
(Total 10 marks)

Suggested Answers to Question Seven:

Chapter 03 – Business Processes

(a) ***(Identifying any four of the below would permit full marks)***

1. Disna Tea Shop :

Usual credit period is 30days, but it has not paid for more than 60days. GRN is also not given. So, it is necessary confirm the value through confirmation.

2. Rizna Meat Shop :

GRN 4766 value is Rs.105,460/-. However, creditors again sheet shows Rs.142,230/- So it is necessary to get the correct value.

3. Wijaya Distributors :

GRN value is Rs.47,900/-. But it is not showing in the creditors list. Is it because that is has already settled? It is necessary to get the external confirmation.

4. Fresh Vegetables Mart :

Through credit period is 30days it has not paid for more than 30 days.

(04 marks)

(b) (Listing any two of the below would permit full marks)

- 1 Checking invoices of trade creditors.
- 2 Checking the payments received from trade creditors.
- 3 Checking the invoices with GRN.
- 4 Checking subsequent payments.
- 5 Cut-off procedures.

(03 marks)

(c) Financial reporting frameworks ordinarily identify two type of events,

1. Those that provide evidence of conditions that existed at the date of the financial statements.
2. Those that provide evidence of conditions that arise after the date of the financial statements.

The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of financial statements and the date of the auditor's report that require adjustment of, disclosure in, the financial statements have been identified.

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(03 marks)

(Total 10 marks)

Suggested Answers to Question Eight:

Chapter 03 - Internal Control System and Business Processes

(a) (Explaining any two of the below would permit full marks)

1. The Subcontractor is required to produce two (02) samples for the approved design but only **D Fashion Ltd.** approves the sample. No approvals given by the customer. There is a possibility of rejecting the orders by the customers due to deficiencies in the quality or design.
2. **D Fashion Ltd.** does not have a proper mechanism to collect the debt from long-outstanding customers.
3. The subcontractors do not provide a credit period to **D Fashion Ltd.**, but **D Fashion Ltd.** Provides a one-month credit period to customers. This may create liquidity issues for **D Fashion Ltd.**
4. Subcontractors expect advance payment if the order value is over one (01) million. But **D Fashion Ltd** accepts the customers' orders without any advance.
5. Even though sub-contractors do not provide a credit period, **D Fashion Ltd.** has payable balances in the accounts of two subcontractors.
6. Having over fifteen million stocks in store that had not been taken away by the customers.
7. Once the GRN is approved payments are made. Before making the payment GRN is not matched with the invoices or any other supporting documents.

(06 marks)

Chapter 03 - Internal Control System and Business Processes

(b) (Explaining any three of the below would permit full marks)

- (1) **Segregation of duties** – Assigning the work responsibility for recording transactions, authorizing transaction and maintaining custody of assets to different employees to minimize the risk of fraud and error.
 - Payment vouchers should be prepared by the bookkeepers and should approve by the accountant.
 - In a supplier payment process there should be different employees to authenticate the invoice, record in the ledger and to make the payment.

(2) **Physical Controls** – To prevent unauthorized access. Using bio matrix controls to avoid unauthorized accesses to certain areas of the business.

- Using bio matrix controls to avoid unauthorized accesses to certain areas of the business

(3) **Authorization and Approval** – Approval of actions prior to being processed.

- All credit sales should be approved by the accountant or higher management.
- Procurement manager approves the purchase order prepared by the procurement executive before sending to supplier.

(4) **Management Controls** – Management performance review.

- Management should review the payments and receivables mechanism should identify unusual variances.
- Managers compare the budgets and actuals to identify unusual variances

(5) **Supervision Controls** – Supervision/Observation of activities performed by the employees.

- Duties performed by the employees will be supervised by the management of **D Fashion Ltd.**

(6) **Organizational Controls** – Controls are provided by organization structures, such as lines of reporting, lines of authority, authority and responsibility for managers in each position in the organization.

- Having a narrowed organizational structure or Centralization.

(7) **Arithmetical & Accounting Controls** – To check the correct and accurate recording and processing of transactions.

- Monthly reconciliation should be prepared by the finance members.

(8) **Personnel Controls** – Attention should be given to selection, training and qualifications of personnel, as well as personal qualities. The quality of the system will depend on the competence and integrity of the people attached to the process.

- Ensuring capable and skilled employees are occupied in the production areas.

(06 marks)

Chapter 03 - Internal Control System and Business Processes

(c) (Explaining any two of the below would permit full marks)

Preventive Controls:

1. To prevent payments to subcontractors for manufacturing of unsuitable garments (which are not matching with the design and sample). This can be achieved by checking the garment at the time of raising GRN's. Person who raises the GRN must check garments on sample basis and ensure that inventory is in accordance with the design approved and sample.
2. To prevent Sub contractors manufacturing of unsuitable garments :
This can be achieved by supervising the manufacturing at random basis whether the manufacturing process is in accordance with design and sample.
3. To prevent violating of company credit policy by customers.
Regular customer follows up by conducting regular customer visits and by sending outstanding reminders to customers.
4. Requesting an advance payment from the customers after approving the design specification.
5. The design should be approved by **D Fashion Ltd.** as well as the customer, before starting commercial manufacturing.

(04 marks)

Chapter 03 - Internal Control System and Business Processes

(d) (Explaining any two of the below would permit full marks)

1 Cash Management Process

Cash management is a high-risk area within an organization due to possible fraud 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.

- Approval for payments
- Orders completed agreed specification

2 Inventory Management Process

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

Here the supervision is necessary over subcontractors manufacturing process since it is important to ensure that final garments are in accordance with design and sample. Also, soon as the GRN's are done it is important to disburse the stock to customers since company has already spent for the inventory.

(05 Marks)

Chapter 03 - Internal Control System and Business Processes

(e)

Application Control	Example
Controls over input accuracy	<ul style="list-style-type: none"> ▪ Programs to check data fields (For example GRN Serial Number, date) on input transactions ▪ Digital verification <ul style="list-style-type: none"> ○ Existence test ○ Necessary Information ○ Permitted Range ▪ Character test ▪ Manual scrutiny of output and reconciliation to source (GRNs)
Controls over input completeness	<ul style="list-style-type: none"> ▪ Manual & programmed agreement of control totals ▪ Document Count one for one
Controls over input authorization.	<ul style="list-style-type: none"> ▪ Manual checks to ensure information input is authorized. ▪ Input by authorized personnel.
Controls over processing	<ul style="list-style-type: none"> ▪ Similar controls to input must be in place when input is completed. (Ex. Batch reconciliation) ▪ Screen warnings can prevent people logging out before processing is complete.
Controls over master files and standing data	<ul style="list-style-type: none"> ▪ One-to-one Checking. ▪ Cyclical reviews of all master files and standing data. ▪ Record counts (no of documentation processed) and hash total (for example, the total of all the payroll numbers) used when master files are used to ensure no deletions. ▪ Controls over the deletion of accounts that have no current balance.

(06 marks) (Total 25 marks)

Suggested Answers to Question Nine:

Chapter 05 – Risk Assessment and Audit Process

(a) (Identifying any five of the below would permit full marks)

- (1) Whether approval has been obtained to start pawning activities from the relevant authorities such as CBSL.
- (2) Whether the minimum capital adequacy is maintained and the capital adequacy ratio is being properly calculated as per CBSL guidelines
- (3) Whether the year-end journal entries are properly adjusted to the Final accounts.
- (4) Whether the impairment provisions are properly calculated and check whether all requirements relating to impairment provisions are complying with the relevant standards.
- (5) Review the validity of the going concern assumption of **YF PLC**. Because a few senior managers have resigned from **YF PLC**, without any replacement.
- (6) Even though **YF PLC** is a finance company, it has invested 25% of its shares in a Non-Finance company. Check whether any contradiction to the **CBSL** guidelines and other requirements.
- (7) Checking the accuracy of the bonus calculation of the CEO.
- (8) Reasons for Non recruitment of senior managers.
- (9) New direction issued by IBSL
- (10) Basis and justification for bonus paid to CEO.
- (11) YF PLC's new acquisitions during the year
- (12) Reasons for reduction of the profitability during the year

(05 marks)

Chapter 05 – Risk Assessment and Audit Process

(b)

The prime responsibility for the prevention and detection of fraud is with the those charged with governance and the management of entity.

An auditor conducting the 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 higher in this case of misstatements than a material misstatement due to an error. This is because fraud may involve a 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 the following audit procedures to reduce the risk.

- 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
- Respond appropriately to fraud or suspected fraud identified during the audit

(05 marks)

Chapter 05 – Risk Assessment and Audit Process

(c) (Identifying any four of the below would permit full marks)

- (1) Elements of the financial statements of YF PLC
- (2) Whether there are items on which users tend to focus.
- (3) Nature of YF PLC, industry and economic situation
- (4) Relative volatility of the benchmark.
- (5) Entity's ownership structure and financing.

(04 marks)

Chapter 05 – Risk Assessment and Audit Process

(d) (Stating any five of the below would permit full marks)

- (1) Accounting principles and industry-specific practices related to the finance sector.
- (2) CBSL and Regulatory framework for a regulated industry
- (3) Legislation and regulation that significantly affect the YF's operations
- (4) Regulatory frame work for a regulated industry.
- (5) Requirements of governing institutes such as Central Bank.
- (6) Industry specific statutory requirements such as capital adequacy.
- (7) Requirements of governing institutes such as Central Bank.
- (8) Taxation of Finance Companies

- (9) Government policies currently affecting the conduct of the Finance business, such as monetary, including foreign exchange controls, fiscal, financial incentives, and tariffs or trade restriction policies
- (10) Governance requirements affecting the industry and the YF's business.
- (11) Environmental requirements affecting the industry and the entity's business.
- (12) The market and competition including demand, capacity and price competition.
- (13) Cyclical or seasonal activity.
- (14) Product technology relating to the entity's product

(05 marks)

Chapter 06 - Audit Evidence

(e) (Stating any six of the below would permit full marks)

- (1) Analyze and discuss YF's latest available interim financial statements.
- (2) Read minutes of the meetings of shareholders, the board of directors, and important committees of YF for reference to financial difficulties.
- (3) Enquire of the YF's lawyer regarding litigation and claims.
- (4) Confirm the existence, legality, and enforceability of arrangements to provide or maintain financial support with related and third parties.
- (5) Assess the Capital Adequacy Ratio with relevant requirements.
- (6) Review events after the period-end for items affecting the entity's ability to continue as a going concern
- (7) Confirm the existence, terms, and adequacy of borrowing facilities
- (8) Obtaining and reviewing the reports of regulatory actions such as CBSL
- (9) Analyze and discuss cash flow, profit and other relevant forecasts with management.
- (10) Review the terms of debentures and loan agreements and determine whether they have been breached.
- (11) Assess the financial ability of such parties to provide additional funds.
- (12) Consider the entity's position concerning unfulfilled customer orders.
- (13) Determining the adequacy of support for any planned disposal of assets.

(06 marks)
(Total 25 marks)

End of Section C

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