



Association of Accounting Technicians of Sri Lanka

Level III Examination – January 2024

Suggested Answers

(303) FINANCIAL CONTROLS & AUDIT (FCA)

Association of Accounting Technicians of Sri Lanka

No.540, Ven. Muruththettuve Ananda Nahimi Mawatha,

Narahenpita, Colombo 05.

Tel : 011-2-559 669

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THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

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(303) FINANCIAL CONTROLS & AUDIT

SUGGESTED ANSWERS

(Total 20 Marks)

SECTION - A

Suggested Answers to Question One:

Chapter 01

- (a) i. Partnership
ii. Limited Liability Company

(02 marks)

(b) Taxation

- i. Partnerships – Business profit is included in the personal income of the owner
- ii. Companies – Owners and the company will be taxed separately
- Liability
- i. Partnerships – Personally liable for all the losses and debts of the business (Unlimited liability)
- ii. Companies – Owners are not personally liable for the debt of the company (Limited liability)

(03 marks)

(Total 05 marks)

Suggested Answers to Question Two:

Chapter 02

Opportunity / Benefits of using a Risk Management Framework

Explaining two opportunities / benefits mentioned below adequately covers the requirements for achieving a score of 05 marks

1. **Asset protection** - a solid risk management framework prioritized understanding the risk in time to take the necessary steps to protect the assets and the business.
2. **Reputation Management** - According to the Committee Of Sponsoring Organization of the Tradeway Commission, risk management must be implemented by many different

players in the organization, each of whom can play an active role in mitigating risk. Adopting a strong risk management Framework allows organizations to monitor all the publicities they are getting via public media.

3. **Limited liability Chain Risk:** The complexity of global supply chains requires constant monitoring to stay informed of risk at the level of a large and rapidly changing marketplace. The risk management Framework improves the quality of information streams from external and internal sources.
4. **Intellectual property protection** - All companies have an IP risk, You are exposed to potential intellectual property theft
5. **Competitor Analysis** - A robust risk management framework facilitates competitor analysis by systematically identifying and prioritizing risks associated with competitive actions, enabling businesses to allocate resources effectively. By integrating competitive intelligence within the framework, businesses can develop proactive response strategies to mitigate threats and capitalize on opportunities, ultimately enhancing their competitive advantage.

(05 marks)

Suggested Answers to Question Three:

Chapter 04

(a) The three parties are:

- **The Intended User of the Information**

Intended Users are the recipients of services, assets or information of the responsible party who are affected by the activities of the responsible party. Where appropriate, users may also receive information in relation to the operations of the responsible party.

- **The Practitioner**

Practitioner is engaged in an assurance engagement with the aim of obtaining sufficient appropriate evidence in order to express a conclusion designed to enhance the degree of confidence of the intended users

- **The Responsible party**

Performs operations / Provides information for the benefit or relevant to users. This party is responsible for the subject matter over which assurance is sought.

(03 marks)

(b)

Stating two differences mentioned below adequately covers the requirements for achieving a score of 02 marks

Reasonable and limited assurance	
Reasonable assurance	Limited assurance
Gives a high level of assurance	Gives a low or moderate level of assurance
Gives a positively worded assurance opinion	Gives a negatively worded assurance opinion
The practitioner gathers sufficient appropriate evidence to be able to draw a reasonable conclusion	The practitioner gathers sufficient appropriate evidence to be able to draw a limited conclusion
Concludes that the subject matter conforms in all material aspects with identified suitable criteria.	Concludes that the subject matter, with respect to identified suitable criteria, is applicable only to the circumstances
Performs very thorough procedures to obtain sufficient appropriate evidence – Test of controls and substantive audit procedures	Performs fewer procedures – Mainly enquiries and analytical procedures.

(02 marks)
(Total 05 marks)

Suggested Answers to Question Four:

Chapter 09

(a) The firm shall establish policies & and procedures designed to provide reasonable assurance. That the firm, its personnel, and others (if applicable) are subject to Independence requirements.

Such policies & and procedures shall enable the firm to

- a) Communicate its independence requirements to its personnel
- b) Identify and evaluate circumstances and relationships that create threats to independence and take appropriate actions to eliminate those threats or reduce them.

(03 marks)

(b) Stating two matters mentioned below adequately covers the requirements for achieving a score of 02 marks

1. The work has been performed by professional standards and applicable legal and regulatory requirements
2. Significant matters have been raised for further consideration
3. Appropriate consultations have taken place and the resulting conclusions have been documented and implemented
4. There is a need to revise the nature, timing, and extent of work performed
5. The work performed supports the conclusions reached and is appropriately documented
6. The evidence obtained is sufficient and appropriate to support the report
7. The objectives of the engagement procedures have been achieved



(02 marks)
(Total 05 marks)

End of Section A

Suggested Answers to Question Five:***Chapter 05***

(a)

Explaining three matters mentioned below adequately covers the requirements for achieving a score of 06 marks

THE OVERALL AUDIT STRATEGY MATTERS TO CONSIDER	
Characteristics of the engagement	<ul style="list-style-type: none"> • Financial reporting framework • Industry-specific reporting requirements. • Expected audit coverage (e.g. No. of locations) • Nature of the control relationships (e.g. Group Audits) • Nature of business segments. • The reporting currency to be used. • Availability of internal audit work. • Use of service organizations (Business Process Outsourcing) and how they have designed controls. • Audit evidence obtained from previous audits. • Effect of information technology on audit procedures. • Availability of client personal data.
Reporting objectives, the timing of the audit, and nature of communications	<ul style="list-style-type: none"> • Entity's timetable for reporting • Organization meeting with management and those charged with governance • Discussions with management and those charged with governance regarding the expected types and timing of reports • Expected communication regarding the status of the audit throughout the engagement • Expected communication with component auditors • Expected communications with third parties
Significant factors, preliminary engagement activities, and knowledge gained on other engagements	<ul style="list-style-type: none"> • Determination of materiality. • Identification of areas identified with a higher risk of material misstatement and its impact at the overall financial statement level. • Results of previous audits. • Need to maintain professional skepticism.

	<ul style="list-style-type: none"> • Evidence of management’s commitment to design, implementation, and maintenance of sound internal control. • Volume of transactions. • Significant business developments. • Significant industry developments. • Significant changes in the financial reporting framework. • Other significant recent developments.
Nature, Timing, and extent of resources	<ul style="list-style-type: none"> • Selection of Engagement Team. • Assignment of work to team members. • Engagement budgeting.

(06 marks)

(b) Stating four areas mentioned below adequately covers the requirements for achieving a score of 04 marks

The auditor shall obtain an understanding of the following;

- A. Construction and gem industry, regulatory, and other external factors including the applicable financial reporting framework.
- B. The nature of the construction and civil engineering services and gem, including
 - I. Its operations
 - II. Its ownership and governance structure
 - III. The types of investments that the construction and civil engineering services and gem is making and plans to make, including investments in special purpose entities; and
 - IV. The way the construction and civil engineering services and gem are structured and how it is financed
- C. The entity’s selection and application of accounting policies, including its appropriateness and consistency in the business industry.
- D. Internal controls over the gem purchases, gem cutting et. And operations process over the gem cutting.
- E. The entity’s objectives and strategies and those related business risks that may result in risks of material misstatement.
- F. The measurement and review of the entity’s financial performances.
- G. Major changes in clients business

(04 marks)
(Total 10 marks)

Suggested Answers to Question Six:

Chapter 05

(a) Fraud - An international act by one or more individuals among management, those charged with governance, or employees of third parties, involving the use of deception to obtain an unjust or illegal advantage.

(03 marks)

(b)

An auditor conducting the audit per SLAuS is **primarily 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.

Primary responsibility for the prevention and detection of fraud is with these changed with the governance and management. However the auditor should perform audit procedures to reduce the risk.

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(04 marks)

(c)

- **AB Tourists** – Having a long outstanding (Rs.1,350,000) balance for more than 120 creates a higher risk of fraud or error.
- **Lanka Visitors** - Having a minus (Rs.650,000) balance creates a higher risk of fraud or error –Not posting sales invoices related to Lanka Visitors
- **Gulf Tours** – Even though there are long outstanding unsettled balances, the continuation of credit sales to Gulf Tours creates a higher risk of fraud or error

Alternative Answer:

- Incentive
- Opportunities
- Attitudes/Rationalization

(03 marks)

(Total 10 marks)

Suggested Answers to Question Seven:

Chapter 08

(a) Explaining two aspects mentioned below adequately covers the requirements for achieving a score of 03 marks

1. Before accepting a new client relationship, a professional accountant in public practice shall determine whether acceptance would create any threats to compliance with the fundamental principles.
2. A professional accountant in public practice shall evaluate the significance of any threats and apply safeguards when necessary to eliminate them to an acceptable level.
3. The fundamental principle of professional competence and due care imposes an obligation on a professional accountant in public practice to provide only those services that the professional accountant in public practice is competent to perform
4. Whether sufficient staffs with necessary competencies are available to carry out the audit.
5. The auditor shall determine whether financial reporting framework to be applied in the preparation of financial statements
6. The auditor shall agree to terms of the audit engagement with management or those charge with governance.

(03 marks)

(b) Mentioning two threats mentioned below adequately covers the requirements for achieving a score of 04 marks

1. Intimidation Threat

- Here the obtaining the bank loan is a prime target of the client and therefore forecast report may have prepared in a way that it will suit to clients loan requirements. Auditor may get the same pressure at the external audit time.

2. Self Interest Threat

- If the audit of SGL is accepted, 25% of the revenue of the firm will be from it. That means it represents a significant portion of the income of the audit firm. That is the audit firm is having an undue independence on total fee from SGL.

3. Self-Review Threat

- The threat that a professional accountant will not appropriately evaluate the results of a previous judgement made. There is a possibility that client may want other services from the audit firm such as preparation of other reports to different authorities in future, as well the way they prepared the financial forecast for the bank for the purpose of loan. It will create self-review threat.

(04 marks)

(c) Stating three safeguards mentioned below adequately covers the requirements for achieving a score of 03 marks

1. Discussing ethical issues with those charged with governance of the client.
2. Possessing or obtaining experience with relevant regulatory requirements
3. Assigning sufficient staff with the necessary competencies
4. Disclosing to those charge with governance of the client the nature of services provided and extent of fees charged
5. Complying with quality control policies and procedures designed to provide reasonable assurance that specific engagements are accepted only when they can be performed competently.
6. Existence of leadership which ensures the compliance with the fundamental principles while establishing the expectation that the members of an assurance team will act in the public interest.
7. Documented policies and procedures to identify the threats to compliance with the fundamental principles, evaluate the significance of those threats, and apply safeguards to eliminate or reduce the threats.
8. Timely communication of firm's policies and procedures, including any changes to them, to all partners and professional staff, and appropriate training and education on such policies and procedures.
9. Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client
10. Consulting an independent third party, such as a professional regulatory body or another professional accountant
11. Having a professional accountant who was not a member of the assurance team review the assurance work performed or otherwise advise as necessary.
12. Having a professional accountant who was not involved with the non- assurance service review the non- assurance work performed or otherwise advise as necessary.

(03 marks)

(Total 10 marks)

End of Section B

Suggested Answers to Question Eight:***Chapter 03***

(a)

Mentioning five weaknesses mentioned below adequately covers the requirements for achieving a score of 05 marks for (a) – (i)

Mentioning five recommendations below adequately covers the requirements for achieving a score of 05 marks for (a) – (ii)

(i) Weaknesses	(ii) Recommendations
<ul style="list-style-type: none"> The Purchasing Executive places orders based on the Inventory Officer's request. 	<ul style="list-style-type: none"> The inventory officer's requests should be properly authorized by an independent / higher-level manager
<ul style="list-style-type: none"> The company has no proper controls in place in selecting suppliers for registration. 	<ul style="list-style-type: none"> Developing a transparent system for the registration of suppliers.
<ul style="list-style-type: none"> Monthly physical inventory counts are taken by inventory officers 	<ul style="list-style-type: none"> Monthly physical inventory counts are taken by independent officers
<ul style="list-style-type: none"> Stock counts are adjusted in the system on physical inventory count. 	<ul style="list-style-type: none"> Should introduce a proper approval level for all system adjustments on physical counts.
<ul style="list-style-type: none"> Certain controls have not been implemented by the relevant staff due to not understanding the risk behind the controls. 	<ul style="list-style-type: none"> Organize a few awareness programs for the staff to increase their knowledge of internal controls.
<ul style="list-style-type: none"> The Inventory Officer has no adequate knowledge to check the quality of certain items 	<ul style="list-style-type: none"> Give proper training to the inventory officer.
<ul style="list-style-type: none"> Daily sales reports could not be generated from the sales system. 	<ul style="list-style-type: none"> Develop the system to enable the option of daily sales reports.
<ul style="list-style-type: none"> Prices stated in the sales invoices are different from quotations. 	<ul style="list-style-type: none"> Implement a control to cross-check the quotation, before setting the sales prices.
<ul style="list-style-type: none"> Debtor balances do not appear in the debtor list. 	<ul style="list-style-type: none"> Getting a daily report of debtors and cross-checking with daily credit sales.
<ul style="list-style-type: none"> The sales system was out of order for a day due to a virus attack 	<ul style="list-style-type: none"> Install a virus guard to the system.
<ul style="list-style-type: none"> Not available any backups 	<ul style="list-style-type: none"> Establish a system to store backup at a remote place.

(b) (i)

Mentioning four controls mentioning below adequately covers the requirements for achieving a score of 04 marks.

- Separation of duties – system developments should be checked by two personnel
- Access control – Limit access to the stores only to the authorized offers
- Approval Authority – system adjustments should be approved by a higher management level.
- Periodic trial balances – Monthly stock taken should be done by independent officers
- Supervision controls over inventory counts
- Arithmetic and accounting controls
- Personal Control

(04 marks)

(ii)

Controls within an organization are also meant to encourage efficient and effective use of resources, including personnel, to optimize the company's goals. An important part of these controls is accurate information for internal decision-making and Safeguarding assets and records

(03 marks)

(c) Mentioning four limitations mentioning below adequately covers the requirements for achieving a score of 04 marks.

- Controls may not be well designed.
- Controls may not be implemented as required. Therefore, even a well-designed control may not be able achieve its objectives.
- Continue changes in operational risks. As a result of the pre designed controls may fail to address new risks.
- Cost of designing and implementing controls does not justify the benefits delivered from those controls.
- Poor risk awareness culture within the organization.
- Non routine transactions are not covered
- Human errors

(04 marks)

(d) Mentioning two controls mentioning below adequately covers the requirements for achieving a score of 04 marks.

Application Controls

- i. Controls over input completeness.
- ii. Controls over input accuracy.
- iii. Controls over input Authorization.
- iv. Controls over processing
- v. Controls over master files and standing data

General Controls

- i. Development of computer application.
- ii. Prevention or detection of unauthorized change to programs.
- iii. Testing and documentation of program changes.
- iv. Controls to prevent unauthorized amendments to data files.
- v. Control to ensure continuity of operations.

(04 marks)

(Total 25 marks)

Suggested Answers to Question Nine:

Chapters 06 and 07

(A)

(a) Explaining two analytical procedures mentioning below adequately covers the requirements for achieving a score of 03 marks.

- Comparable information for prior periods.
- Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.
- Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.
- Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages.
- Between financial information and relevant non-financial information, such as payroll costs to number of employees.

(03 marks)

(b)

- Risk assessment has not been performed to understand the level of risk relating to current year. Even though it is only a disclosure, it is one of the significant disclosures in the financial statements.
 - List of related parties and transactions have not been obtained from the management.
 - Investment in D LTD. has been assessed for existence of control or significant influence.
 - Inquiries have not been made from directors, management and other relevant persons within the entity.
 - Engagement team discussion has not been performed.
 - Whether there are changes to terms and conditions of loans has not been checked.
- Accordingly, the auditor has not performed adequate audit work on RPT.

(05 marks)

(c) The auditor has a responsibility to perform audit procedures to identify, assess and respond to the risk of material misstatements due to related party transactions. However, the auditor cannot be expected to detect all material related party transactions due to inherent limitations of the audit.

(03 marks)

(d) Mentioning two audit procedures mentioned below adequately covers the requirements for achieving a score of 04 marks.

Audit procedures that can be performed in reviewing the events after the reporting period;

I. Obtaining an understanding of any procedures, management has established to ensure that subsequent events are identified.

II. Inquiring if management and TCWG as to whether any subsequent events have occurred which might affect the financial statements.

III. Reading minutes of the meetings of the entity's owners, management and TCWG that have been held after the date of the financial year and inquiring about matters discussed at any such meetings for which minutes are not yet available.

IV. Reading the entity's latest subsequent interim financial statements.

V. Read budgets, cash flow forecasts and other related management reports prepared after the balance sheet date.

VI. Inquire from the legal counsel concerning litigation and claims.

VII. Obtain written representations from the management.

(04 marks)

(B)

A Ltd.

- Company's materiality level is Rs.1,000,000/-
- There is significant noncompliance with SLFRS 15 and Cut off error
- Those issues have affected the profit, inventory, sales, and trade receivables
- Impact is pervasive
- **Auditor should express an adverse opinion based on the above factors**

B Ltd.

- Company's materiality level is Rs.125,000/-
- The auditor has obtained sufficient and appropriate evidence for non-provision of Rs.150,000/- (long outstanding debtor balance)
- Impact is material but not pervasive
- **The auditor should express a qualified opinion based on the above factors**

C Ltd.

- Company's materiality level is Rs.5.75 million
- The auditor is unable to obtain sufficient and appropriate evidence on trade receivables amounting to Rs. 7,768,000/- (represent 5% of the total assets)
- Impact is material but not pervasive
- **The Auditor should express a qualified opinion based on the above factors**

(10 marks)
(Total 25 marks)



End of Section C

Notice:

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