Instructions to candidates:

(1) **All questions should be answered.**
(2) **Answers should be in one language, in the medium applied for, in the booklets provided.**
(3) **Use of calculators is permitted.**
(4) **Submit all workings and calculations. State clearly assumptions made by you, if any.**
(5) **100 Marks.**

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**01.** (a) Briefly explain the difference between “Statutory Audit” and “Private Audit”. (03 marks)

(b) List three(03) benefits from an audit of a limited liability company to its shareholders and Directors / Management. (03 marks)

(c) State four(04) advantages of an interim audit. (04 marks)

(d) Briefly explain the following fundamental principles stated in the Code of Professional Conduct and Ethics applicable for the members of AAT Sri Lanka:
   (i) Integrity. (04 marks)
   (ii) Professional Behaviour. (04 marks)

(e) State and briefly explain two(02) objectives of the quality control policies to be adopted by an audit firm. (06 marks)

(Total 20 marks)

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**02.** (a) (i) What is meant by the term “audit risk”? (02 marks)

(ii) State and briefly explain the three(03) components of audit risk. (06 marks)

(b) State four(04) reasons why detection risk cannot be eliminated completely. (02 marks)

(c) You are the senior in charge of the team auditing the financial statements of **XYZ (Pvt) Ltd.** for the year ended 31st March 2013. Your manager informs you that there is an increased risk of fraudulent financial reporting in **XYZ (Pvt) Ltd.** as the sales value reported for the year in the financial statements is just above the target given to Sales Managers. By achieving this target, the Sales Managers of **XYZ (Pvt) Ltd.** are to receive an increased bonus.

   (i) Identify two(02) techniques in which management can fraudulently report a higher sales value than the actual sales value. (02 marks)

   (ii) State two(02) audit procedures that you would perform to address this risk. (04 marks)

(Total 16 marks)
03. (a) List two (02) factors that determine the extent of audit planning. (02 marks)

(b) List three (03) factors that the auditor should consider in designing further audit procedures to be performed in respect of risks of material misstatement at assertion level. (06 marks)

(c) Your firm has been appointed as the auditor of Full Life (Pvt) Ltd. for the year ended 31st March 2013. Full Life (Pvt) Ltd. distributes pharmaceutical products island-wide. State two (02) procedures that you should perform as an auditor as part of the risk assessment procedures to obtain an understanding of the entity and its environment including its internal controls. (02 marks)

(d) State three (03) factors influencing the sample size to perform substantive audit procedures. (03 marks) (Total 13 marks)

04. (a) State three (03) objectives of establishing application controls in a computerized information systems (CIS) environment. (03 marks)

(b) ABC (Pvt) Ltd. is a company that develops IT software for local and overseas clients and its financial year ended on 31st December 2013. During the financial year, ABC (Pvt) Ltd. replaced half of its existing old computers by purchasing 45 new computers. The computers were purchased from a supplier recommended by the IT manager. A purchase order was raised by the accountant. The computers were received by the administration manager. The supplier has forwarded the invoice for 45 computers to the accountant who has checked it against the purchase order and approved it for payment. The computers listed in the supplier invoice were entered in the fixed asset register of ABC (Pvt) Ltd. The fixed asset register was reconciled to the general ledger at the financial year end.

(i) State three (03) weaknesses in the internal controls of the process explained above. (03 marks)

(ii) Explain how you would overcome each of these weaknesses and strengthen the internal control system. (06 marks)

(c) You are the senior in charge of the team observing the financial year end stock count in the warehouse of Upul (Pvt) Ltd. on 31st March 2013. Upul (Pvt) Ltd. imports and sells brand new and reconditioned spare parts of Motor Vehicles. During the stock count, you have observed the following:

(1) There were several damaged spare parts.

(2) You noted that several items of inventory were at the entrance to the warehouse. You have been informed by the warehouse supervisor that these goods have just been arrived in the morning of the count and those have not been entered in the inventory ledger yet.

(3) There were two items of spare parts with significant shortages.

In relation to each of the above observations, state a substantive procedure each, you should perform both during the stock count and after the stock count. (06 marks) (Total 18 marks)
05. (a) Briefly explain the difference between “test of controls” and “substantive procedures”. 

(b) State two(02) substantive audit procedures you should perform to obtain audit evidence for each of the following: 
   (i) Existence of fixed deposits. 
   (ii) Completeness of accrued expenses. 
   (iii) Accuracy of salaries. 

(c) You are working as an audit senior of **ABC & Company** which is a firm of Chartered Accountants. **Indika** who had been recruited recently as an audit assistant sought clarifications as to why you should perform the following procedures in an audit of a limited liability company:

   (1) Inquiring from company’s lawyers about pending litigations against the company.
   (2) Checking the title deed of a newly purchased land.

   **You are required to**, state a reason for performing each of the above audit procedures. The reasons should refer to the relevant assertions in obtaining audit evidence. 

(d) (i) State two(02) reasons why external confirmations are considered as reliable audit evidence. 

(ii) State four(04) situations in which external confirmations can be used as audit evidence. 

(Total 18 marks)

06. (a) Briefly explain the functions of “COPE”. 

(b) What is meant by “Corporate Governance”? 

(c) List two(02) important matters stated in the “Opinion” paragraph of the auditor’s report. 

(d) State three(03) audit procedures the auditor should perform to identify subsequent events occurred up to the date of the auditor’s report. 

(e) State three(03) operating events or conditions that may cast significant doubts about going concern assumption of an entity. 

(Total 15 marks)