01. (a) State two (02) reasons as to why audit of financial statements is necessary. (02 marks)

(b) What do you understand by an internal audit? How is it different from a statutory audit? (04 marks)

(c) Distinguish between “Fraud” and “Error” giving two (02) examples of each. (04 marks)

(d) A partner of XYZ audit firm informs one of his audit clients that there are inherent limitations of an audit and as a result there is an unavoidable risk that some material misstatements of financial statements may not be detected from an audit.

Briefly explain two (02) inherent limitations of an audit in detecting all material misstatements in financial statements arising from fraud and error. (04 marks)

(e) Briefly explain the following fundamental principles stated in the Code of Professional Conduct and Ethics applicable for the members of AAT Sri Lanka:

(i) Objectivity. (04 marks)

(ii) Confidentiality. (04 marks)

(Total 18 marks)

02. (a) List three (03) ways that could be used for fraudulent financial reporting by the management of a business organization. (03 marks)

(b) List three (03) factors influencing the sample size for tests of controls. (03 marks)

(c) List three (03) factors that would affect the sufficiency of audit evidence gathered by an auditor. (03 marks)

(d) List two (02) preliminary engagement activities an auditor should perform at the beginning of an audit for an existing audit client. (04 marks)
(e) You have observed the following when performing analytical procedures for the financial statements of *Matara Stores (Pvt) Ltd*:

- The debt collection period has increased by 50% over the previous financial year.
- The stock turnover has reduced by 50% over the previous financial year.

Briefly explain the main audit risk arising from each of the above observations.

(04 marks)

(Total 17 marks)

03. (a) State three(03) reasons as to why it is important for an auditor to obtain an understanding of internal controls relevant to the audit client’s business organization. (03 marks)

(b) Briefly explain three(03) limitations of internal control. (03 marks)

(c) *Rantharu (Pvt) Ltd.* is in the business of manufacturing and selling of soft toys. The company is operating in a manual environment where functions such as accounting, inventory and debtors management, raising invoices etc. are being done manually.

**Tharu,** Managing Director of the company is considering a proposal to computerize all the above activities and introduce an IT system complete in all respects to the company.

(i) State four(04) benefits the proposed IT system would bring to ensure efficiency and effectiveness of the internal controls of *Rantharu (Pvt) Ltd.*

(ii) State three(03) risks arising from the proposed IT system to the internal controls of *Rantharu (Pvt) Ltd.* (07 marks)

(d) *Araliya (Pvt) Ltd.* produces coconut oil for the local market. **Hemantha** who is the storekeeper of *Araliya (Pvt) Ltd.* places purchase orders when stock level reaches re-order level. The quantity ordered is determined based on the weekly production plan. When coconuts are received in the stores, **Hemantha** verifies the quantity and quality and raises a GRN. **Hemantha** checks the accuracy of the supplier's invoice and sends it to the finance department to release the cash required to pay the supplier. **Hemantha** acknowledges receipt of the cash from the finance department and hands over the cash to the supplier. The finance department performs a monthly inventory count at the stores to verify the stock levels.

State three(03) weaknesses in the internal control system explained above and explain how you would overcome each of those weaknesses. (09 marks)

(Total 22 marks)

04. (a) Briefly explain why it is important for an auditor to agree with the client on the terms of the audit engagement. (03 marks)

(b) State four(04) factors that should be considered when reviewing the audit work performed by assistants. (04 marks)
You are a member of the team auditing the financial statements of Hiru PLC for the year ended 31st March 2013. Your senior has assigned you to audit the Property, Plant and Equipment of Hiru PLC. You have noted in your preliminary analytical review that there has been a significant increase in Property, Plant and Equipment of the company during the year ended 31st March 2013.

(i) State three(03) internal controls that you would expect to exist in relation to Property, Plant and Equipment of Hiru PLC.

(ii) List one audit procedure each you would perform to verify existence, valuation and ownership of Property, Plant and Equipment of Hiru PLC. 

(06 marks)

(Total 13 marks)

05. (a) State three(03) factors to be considered by an auditor when the said auditor acts as the principal auditor of a group of companies. 

(03 marks)

05. (b) Briefly explain the following:

(i) Auditing around the computer.

(ii) Auditing across the computer. 

(04 marks)

(c) You are working as an audit senior of a firm of chartered accountants. Isuru, who had been recruited recently as an audit assistant sought clarifications from you as to why you should perform the following procedures in an audit.

(i) Physically verifying a sample of Property, Plant and Equipment listed in the fixed assets register.

(ii) Scrutinizing the payments made after the financial year-end.

(iii) Checking unrealized deposits shown in the financial year-end bank reconciliation with the subsequent month’s bank statement.

(iv) Checking the subsequent realization of debtors outstanding as at the date of statement of financial position.

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

(08 marks)

(Total 15 marks)

06. (a) (i) State who can appoint the Auditor General of Sri Lanka.

(ii) State two(02) rights/powers of the Auditor General of Sri Lanka. (03 marks)

(b) Briefly explain under which circumstances an auditor will express the following types of audit opinion:

(i) Disclaimer of opinion.

(ii) Adverse opinion. 

(04 marks)

(c) State four(04) important matters included in the “Opening or introductory paragraph” and “Scope paragraph” of the auditor’s report. 

(04 marks)

(d) Briefly explain how the appointment of the auditor of a company should take place after the first year as per Companies Act No. 07 of 2007. 

(04 marks)

(Total 15 marks)