(61) AUDITING

Time: 03 hours

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.

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

(b) State four(04) enterprises which are considered as Specified Business Enterprises. (04 marks)

(c) State four(04) activities carried out by an internal auditor. (04 marks)

(d) Briefly explain two(02) general principles governing an audit of financial statements. (04 marks)

(e) Briefly explain the responsibility of a member with regards to client’s money entrusted to him as stated in the Code of Professional Conduct and Ethics applicable for the self-employed members of AAT Sri Lanka. (04 marks)

(Total 19 marks)

02. (a) Briefly explain, what is meant by “Overall Audit Strategy”. (03 marks)

(b) Briefly explain the relationship between materiality and audit risk. (03 marks)

(c) Assume that Secure Bank PLC is a commercial bank which is licensed by the Central Bank of Sri Lanka. Your audit firm has been appointed as the auditor of Secure Bank PLC for the year ended 31st March 2014.

State two(02) procedures that you should perform as an auditor to obtain an understanding of the entity and its environment including its internal controls. (02 marks)

(d) An auditor should obtain a written representation from the management in respect of fraud. State three(03) matters which should be included in the management representation in respect of fraud. (03 marks)

(Total 11 marks)

03. (a) State four(04) types of audit procedures that could be used to obtain audit evidence. (04 marks)

(b) “Audit evidence is more reliable when it is obtained from independent sources such as those from outside the entity”. Give two(02) examples of such audit evidence. (02 marks)
(c) State four (04) factors to be considered by an auditor in determining the form and content of audit working papers. (04 marks)

(d) **Super Star (Pvt) Ltd.** manufactures garments for the local market. Based on the production plan and re-order level, the storekeeper purchases all the required fabric from **ABC Ltd.**, a local fabric supplier. The storekeeper informs the supplier about purchase requirements over the telephone. The fabric supplier submits the invoice to the accountant to process the payment. Once the Factory Manager approves the supplier invoice, the accountant processes the payment.

List three (03) weaknesses in the internal control system explained above and explain how you would overcome each of these weaknesses. (06 marks) (Total 16 marks)

04. (a) State three (03) matters that should be considered by the auditor when using Computer Assisted Audit Techniques (CAATs). (03 marks)

(b) (i) Briefly explain the purpose of introducing general controls in respect of Computerized Information System (CIS). (02 marks)

(ii) List three (03) types of general controls. (03 marks)

(c) State three (03) matters to be considered by an external auditor in evaluating the adequacy of the work performed by the internal auditor. (03 marks)

(d) Briefly explain three (03) audit procedures to be performed by an auditor when prior periods financial statements were audited by another auditor. (03 marks)

(e) List two (02) factors to be considered by an auditor in determining the need to use the work of an expert. (04 marks) (Total 18 marks)

05. (a) Briefly explain circumstances in which an auditor performs tests of controls rather than relying only on substantive procedures. (03 marks)

(b) State an audit procedure you should perform in verifying Motor Vehicles to obtain audit evidence for each of the following assertions:

(i) Completeness.

(ii) Valuation.

(iii) Existence. (03 marks)

(c) You are a member of the team auditing the financial statements of **Matara Traders (Pvt) Ltd.**

(i) List four (04) tests of controls that you should perform in verifying Trade Receivables. (04 marks)

(ii) List four (04) substantive procedures in respect of credit sales. (04 marks)
You are a member of the team auditing the financial statements of **Tasty (Pvt) Ltd.**, a chocolate manufacturer. **Sarath** who is another member of the audit team has observed the physical verification of stocks as at 31st March 2014 of **Tasty (Pvt) Ltd.** He has noted the following observations in working papers. You have been assigned to perform the remaining procedures relating to verification of stock balance.

<table>
<thead>
<tr>
<th>Item</th>
<th>Unit of measurement</th>
<th>Balance as per stock ledger</th>
<th>Physical balance</th>
<th>Excess / (Shortage)</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tasty milk chocolate 100g</td>
<td>Cases</td>
<td>900</td>
<td>900</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Tasty fruit &amp; nut chocolate 100g</td>
<td>Cases</td>
<td>300</td>
<td>241</td>
<td>(59)</td>
<td>-</td>
</tr>
<tr>
<td><strong>Tasty fruit &amp; nut chocolate 200g</strong></td>
<td>Cases</td>
<td>3,000</td>
<td>2,800</td>
<td>(200)</td>
<td>The expiry dates for 200 cases had passed and were kept separately from the stock.</td>
</tr>
<tr>
<td>Tasty cooking chocolate powder 250g</td>
<td>Cases</td>
<td>850</td>
<td>850</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Tasty cooking chocolate powder 500g</td>
<td>Cases</td>
<td>500</td>
<td>100</td>
<td>(400)</td>
<td>-</td>
</tr>
<tr>
<td>Computers</td>
<td>-</td>
<td>-</td>
<td>5</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

**You are required to,** identify three (03) audit issues apparent from the above data, giving reasons why special attention should be given for each of those areas during the audit. (06 marks) (Total 20 marks)

06. (a) State two (02) audit procedures the auditor should perform when he detects a non compliance with laws and regulations applicable for that entity. (04 marks)

(b) The auditors of **Easy Leasing (Pvt) Ltd.** has not agreed with the management regarding provision for gratuity in the financial statements. As per the Sri Lanka Auditing Standards, if the disagreement is material to the financial statements, the audit opinion should be modified.

State and briefly explain the two (02) types of modified audit opinions that the auditor of **Easy Leasing (Pvt) Ltd.** could consider in drafting the audit opinion on the financial statements of **Easy Leasing (Pvt) Ltd.** (04 marks)

(c) Briefly explain how the appointment of the first auditor of a company should take place as per the Companies Act No. 07 of 2007. (04 marks)

(d) State four (04) financial events or conditions that may cast significant doubts about the going concern assumption of an entity. (04 marks) (Total 16 marks)