



**ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA**  
**LEVEL III EXAMINATION - JULY 2020**  
**(303) FINANCIAL CONTROLS & AUDIT**

• **Instructions to candidates** (Please Read Carefully):

- (1) **Time Allowed:** *Reading : 15 minutes.*  
*Writing : 03 hours.*

03-10-2020  
Afternoon  
[01.45 – 05.00]

No. of Pages : 08  
No. of Questions : 09

- (2) **All questions should be answered.**
- (3) **Answers should be in one language, in the medium applied for, in the booklets provided.**
- (4) **Submit all workings and calculations. State clearly assumptions made by you, if any.**
- (5) **Use of Non-programmable calculators is only permitted.**
- (6) **Action Verb Check List with definitions is attached. Each question will begin with an action verb. Candidates should answer the questions based on the definition of the verb given in the Action Verb Check List.**
- (7) **100 Marks.**

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**SECTION A**  
(Total 20 marks)

**Question 01**

When the owners of the company are different from the people who manage the company, good corporate governance is always important. The general principles of all forms of corporate governance are generally related to shareholders, board members and other stakeholders.

**You are required to:**

- (a) **Identify** two(02) principles of corporate governance. (02 marks)
- (b) **State** three(03) guidelines on role of Board of Directors that have been highlighted by the Code of Best Practice on Corporate Governance. (03 marks)
- (Total 05 marks)

## Question 02

You are the accountant of **Alpha (Pvt) Ltd.** which engages in import and sale of electrical equipment. A significant loss was made by the business during the last two quarters mainly due to COVID-19 pandemic. You have been requested to prepare a risk analysis report by the Board of Directors.

**You are required to:**

**State** three(03) external risks and two(02) internal risks faced by **Alpha (Pvt) Ltd.** (05 marks)

## Question 03

Assurance engagements play an important role in providing users of financial information, confidence that the information is reasonably accurate and has been properly prepared and presented. Three party relationship is an element of an assurance engagement.

**You are required to:**

**Explain** the three party relationship in relation to an assurance engagement. (05 marks)

## Question 04

Quality control procedures should be established at the firm level and on an individual audit level. Review of the work done by members of engagement team is essential for every individual engagement.

**You are required to:**

(a) **State** any three(03) elements of a system of quality controls. (03 marks)

(b) **Identify** two(02) activities that could be included on an individual engagement under the reviewing the work done by the engagement team members. (02 marks)

(Total 05 marks)

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*End of Section A*

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## **SECTION B**

(Total 30 marks)

### **Question 05**

The following draft Audit Report is prepared by the audit senior of **Green Shipping (Pvt) Ltd.** for the year ended 31<sup>st</sup> March 2020:

**Opinion:**

We have audited the accompanying financial statements of **Green Shipping (Pvt) Ltd.**, which comprise the Statement of Financial Position as at 31<sup>st</sup> March 2020, and the Statement of Comprehensive Income, Statement of Changes in Equity and Statement of Cash Flows for the year then ended, and notes to the Financial Statements, including a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the company as at 31<sup>st</sup> March 2020, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards for Small and Medium-sized Entities (SLFRS for SMEs).

**Responsibilities of Management and Those Charged with Governance for the Financial Statements:**

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards for Small and Medium-sized Entities (SLFRS for SMEs), and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the company's financial reporting process.

**Report on Other Legal and Regulatory Requirements:**

As required by section 163 (2) of the Companies Act No. 07 of 2007, we have obtained all the information and explanations that were required for the audit and, as far as appears from our examination, proper accounting records have been kept by the Company.

Colombo.

**You are required to:**

- (a) **Identify** five(05) elements **not** included in the above audit report. (05 marks)
  - (b) **State** three(03) matters to be considered by the auditor in forming the auditor's opinion. (03 marks)
  - (c) **List** two(02) types of modified opinion. (02 marks)
- (Total 10 marks)

## Question 06

**Rukman Associates (RA)** is a sole practitioner with two (02) seniors and five (05) other junior staff. **RA** is the auditor of **HTP Freight Services (Pvt) Ltd (HTP)** since 2010. **Mr. Rukman** is the engagement partner for the audit of **HTP** since 2010 and **Saman** is the senior in charge of this audit for last three years. Directors of **HTP** requested to accept the valuation of equity instruments of the company. **RA** earns nearly 35% its total revenue from accounting and annual audit services of **HTP** and as such **Mr. Rukman** finds it difficult to deny the client request.

**You are required to:**

- (a) **Explain** three(03) safeguards to be implemented by **Rukman Associates** in accepting the valuation assignment. (06 marks)
- (b) **Explain** threats to compliance with the fundamental principles of ethics applicable to **RA** with reference to the above scenario. (04 marks)
- (Total 10 marks)

## Question 07

- (A) Planning Memorandum should be prepared for each audit engagement. The objectives of such memorandum are to provide a formal record of the planning process and to communicate planning decisions to all levels of the engagement staff.

**You are required to:**

- Recognize** four(04) matters to be included in the Planning Memorandum. (04 marks)
- (B) Audit documentation is the record of audit procedures performed, relevant audit evidence obtained and conclusions the auditor reached.

**You are required to:**

- (a) **Identify** three(03) matters by which the form and content of working papers may get affected. (03 marks)
- (b) **State** three(03) types of information that may be included in the permanent audit file. (03 marks)
- (Total 10 marks)

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*End of Section B*

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## **SECTION C**

(Total 50 marks)

### **Question 08**

- (A) **Student Help Fund (SHF)** is a non-governmental organization (NGO) which deals with provision of educational support for economically challenged children. **SHF** maintains a sub module in SAP, for payroll process.

During the statutory audit of financial year ended 31<sup>st</sup> March 2020, the following information relating to payroll process has been identified by the audit senior:

- Organization's composition consists of a Director, Finance & Administration Manager, Human Resource (HR) Manager, HR Executive, Accounts Executive, Accounts Clerk and five (05) employees.
- Employees are paid based on number of days worked. Manual attendance book is kept at security office to capture attendance records.
- Monthly payroll is calculated by Accounts Executive based on the attendance records received from the security officer.
- Payroll module is updated by Accounts Clerk and approved by the HR Executive. Payroll reconciliations are not prepared by **SHF**.
- Monthly payments are made to bank accounts of respective employees via bank transfer approved by the Finance and Administration Manager.
- Due to the SAP licensing cost, single user login is used by the Finance Department and HR Department.

**You are required to:**

- (a) **Identify** three(03) internal control weaknesses in the above payroll process of **SHF**. (03 marks)
- (b) **State** a recommendation each to overcome above weaknesses. (03 marks)
- (c) **State** two(02) objectives of effective payroll process. (02 marks)
- (d) **List** three(03) examples for IT general controls and two(02) examples for IT application controls to be implemented by **SHF** with reference to the information systems. (05 marks)

- (B) An internal control system refers to processes introduced by the management to help the organizations to accomplish its objectives and goals. The COSO internal control system framework has five components namely, Control Environment, Risk Assessment, Control Activities, Information & Communication and Monitoring. However, the auditor can never eliminate the risk of frauds and errors by implementing internal controls, because there are inherent limitations to the reliance of the internal controls.

**You are required to:**

- (a) **Explain** two(02) objectives of an Internal Control System. (04 marks)
- (b) **State** four(04) control activities. (04 marks)
- (c) **Identify** four(04) inherent limitations of internal controls. (04 marks)
- (Total 25 marks)

### Question 09

- (A) You are the senior in charge of the statutory audit of **BC (Pvt) Ltd.**, a company which manufactures and sells porcelain products to the local market. The following details relating to the audit engagement are extracted from audit planning memorandum and related working papers for the financial year ended 31<sup>st</sup> March 2020:

The company's sales income for the year of Rs. 450 million was derived from the four customers. The details of those customers including credit terms and sales for the month of March 2020 are as follows:

Customer	Sales for the year (in Rs. Million)	Credit terms	Sales for the month of March 2020 (in Rs. Million)
Aero Super	180	60 days	40
Super Food City	120	45 days	10
Associate Company	100	120 days	60
Managing Director's wife	50	240 days	40

Audit team selected **Aero Super** and **Super Food City** for sending confirmations for the trade receivables based on materiality.

The following additional information has also been recognized by the audit team:

- Sales Executive receives orders from the customers and he informs Accounts Executive via an email. Then Accounts Executive raises the invoice and revenue is recognized at the same time.
- Trade receivable balance as at 31<sup>st</sup> March 2020 was Rs.180 million, which consists of Rs. 50 million from Managing Director's wife, Rs.80 million from Associate company and Rs. 50 million from Aero Super.

- The company's arrangement is that customer collects the goods from the company's factory and customer acknowledges the invoice copy and it will be sent to Finance Division for filing.
- Incentive is paid to the Sales team and Managing Director based on sales for the year.

**You are required to:**

- (a) **Identify** four(04) areas that need special attention in performing audit procedures of **BC (Pvt) Ltd.** (04 marks)
- (b) **Identify** three(03) examples of situations where external confirmations may be used by the auditor other than from accounts receivable balances of customers. (03 marks)
- (c) **Explain** the difference between test of controls and substantive procedures. (03 marks)
- (d) **Identify** the party responsible for identification and disclosure of related party transactions. (02 marks)
- (e) **Explain** two(02) risks the audit senior of **BC (Pvt) Ltd.** should consider with respect to related party transactions. (03 marks)
- (B) **RMG Associates** conducted the annual audit of **Hope PLC** (Listed Company in Colombo Stock Exchange) for the financial year ended 31<sup>st</sup> March 2020. The following information was extracted from the audit completion memo. The concerns below were discussed with CFO by the auditor and he is not willing to adjust the financial statements. The financial statement is to be authorized for issue in next week. Materiality used at the planning stage was Rs.10 million based on profit before tax.

**Audit concerns and misstatements:**

- (1) The depreciation on building was understated by Rs.200,000/-.
- (2) Electricity and water charges of Rs. 1 million for the month of March 2020 were not accrued in the books of accounts as at the reporting date.
- (3) The borrowing cost of Rs. 25 million incurred after constructing the company's new factory, was capitalized as a part of construction cost of the building.

**You are required to:**

- (a) **State** three(03) reasons why materiality assessment is important for an auditor. (03 marks)
- (b) **Discuss** the individual impact and overall impact of the above misstatements to the audit. (07 marks)
- (Total 25 marks)

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*End of Section C*

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## **ACTION VERBS CHECK LIST**

Level of Competency	Description	Action Verbs	Verb Definitions
<b>Knowledge (1)</b>	Recall Facts and Basic Concepts.	<b>Draw</b>	Produce a picture or diagram.
		<b>Relate</b>	Establish logical or causal connections.
		<b>State</b>	Express details definitely or clearly.
		<b>Identify</b>	Recognize, establish or select after consideration.
		<b>List</b>	Write the connected items.

Level of Competency	Description	Action Verbs	Verb Definitions
<b>Comprehension (2)</b>	Explain & Elucidates Ideas and Information.	<b>Recognize</b>	Show validity or otherwise, using knowledge or contextual experience.
		<b>Interpret</b>	Translate into understandable or familiar terms.
		<b>Describe</b>	Write and communicate the key features.
		<b>Explain</b>	Make a clear description in detail using relevant facts.
		<b>Define</b>	Give the exact nature, scope or meaning.

Level of Competency	Description	Action Verbs	Verb Definitions
<b>Application (3)</b>	Use and Adapt Knowledge in New Situations.	<b>Reconcile</b>	Make consistent / compatible with another.
		<b>Graph</b>	Represent by graphs.
		<b>Assess</b>	Determine the value, nature, ability or quality.
		<b>Solve</b>	Find solutions through calculations and/or explanation.
		<b>Prepare</b>	Make or get ready for a particular purpose.
		<b>Demonstrate</b>	Prove or exhibit with examples.
		<b>Calculate</b>	Ascertain or reckon with mathematical computation.
		<b>Apply</b>	Put to practical use.

Level of Competency	Description	Action Verbs	Verb Definitions
<b>Analysis (4)</b>	Draw Connections Among Ideas and Solve Problems.	<b>Communicate</b>	Share or exchange information.
		<b>Outline</b>	Make a summary of significant features.
		<b>Contrast</b>	Examine to show differences.
		<b>Compare</b>	Examine to discover similarities.
		<b>Discuss</b>	Examine in detail by arguments.
		<b>Differentiate</b>	Constitute a difference that distinguishes something.
		<b>Analyze</b>	Examine in details to find the solution or outcome.