



ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA
LEVEL III EXAMINATION - JANUARY 2021
(303) FINANCIAL CONTROLS & AUDIT

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

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

20-03-2021
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.**

SECTION A

(Total 20 marks)

Question 01

COVID-19 pandemic has resulted significant challenges to entities in various industries. Examples for changes in external environment due to COVID-19 are as follows:

- Government policy of granting “moratorium” on debt services.
- Government policy of implementing simple tax system.
- Reduction in interest rates.
- Physical meetings were substituted with virtual meetings (e.g. via Skype, Zoom, Teams, etc.).
- Introduction of laws and regulations to follow health guidelines.

You are required to:

Relate each of the above examples with external environmental factors / forces (PESTEL).

(05 marks)

Question 02

Your friend **Raj** wants to know whether the business risk can be completely avoided with risk mitigating techniques.

You have explained him that the business risk cannot be completely avoided even if you follow risk mitigating techniques. Risk avoidance and risk reduction are two techniques used to mitigate risks.

You are required to:

- (a) **Explain** what is meant by risk avoidance with an example. (03 marks)
 - (b) **Identify** two(02) strategies used for risk reduction. (02 marks)
- (Total 05 marks)

Question 03

S & S Lanka (Pvt) Ltd. (S&S) wants to change its external auditors as per the policy of rotating the auditors in every 5 years' period. The board of directors of **S & S** has reached to your audit firm to discuss regarding the handing over of the audit engagement to conduct the annual audit of **S & S** for the year ended 31st March 2021.

You are required to:

- (a) **State** three(03) key aspects and requirements when accepting and managing an assurance engagement of **S & S Lanka (Pvt) Ltd.** (03 marks)
 - (b) **State** two(02) elements of an assurance engagement. (02 marks)
- (Total 05 marks)

Question 04

The objective of the firm is to establish and maintain a system of quality control to provide with reasonable assurance that the firm and its personal comply with professional standards & applicable legal and regulatory requirements and reports issued by the firm or engagement partners are appropriate in the circumstances.

You are required to:

- (a) **Identify** two(02) policies that need to be considered in quality control of an individual engagement. (02 marks)
 - (b) **State** three(03) matters to be included in a system of quality controls with regard to the integrity of a client. (03 marks)
- (Total 05 marks)

End of Section A

SECTION B

(Total 30 marks)

Question 05

You are the audit senior at **Gamage Associates**, an audit firm who is the auditor of **Colonial Trading (Pvt) Ltd.** (“the company”) for the year ended 31st March 2020. The engagement partner has reviewed the audit file and the following information was extracted from the audit completion memo:

- The materiality which was determined based on the profit before tax was Rs.500,000/-.
- The company has constructed a new office building. The construction was completed on 26th February 2020 and the building is being used from 01st March 2020. The cost of building of Rs.15 million was shown under the capital work-in-progress in the Statement of Financial Position as at 31st March 2020. The company depreciates buildings over the useful life of 10 years.
- Inventories valued at cost of Rs. 8 million as at 31st March 2020 was sold during the April 2020 for Rs. 3 million. A loss of Rs.5,000,000/- incurred from this transaction was accounted in the April 2020 by the company.

You are required to:

- (a) **Assess** the impact of the above matters on the audit opinion of Auditor’s Report on Financial Statements for the year ended 31st March 2020. (07 marks)
- (b) **State** three(03) elements included in the Auditor’s Report other than auditor’s opinion. (03 marks)
- (Total 10 marks)

Question 06

(A) **YP (Pvt) Ltd.** (“the company”) engages in supplying of fruits and vegetables to hotels. The board of Directors of the company has requested your firm to conduct the statutory audit for the year ended 31st December 2020. Previous audit firm which is a leading audit firm in the country has declined the audit and it has been communicated in writing to the Board of Directors of the company.

During the preliminary discussion with the management, you noted that the company’s annual turnover stated in the financial statements was Rs. 800 million and the cash at banks was Rs. 1.5 billion. It has come to your attention that there is an ongoing court case against the company, but this was not an agenda item for the preliminary discussion.

Further, the Board of Directors expects the audit to be finalized by 20th April 2021 and during this period all three (03) partners in your firm involve in major deadline audits of the clients and two (02) senior level staff will be seconded to an overseas office.

You are required to:

Assess three(03) matters you need to consider before taking a decision to accept **YP (Pvt) Ltd.’s** audit as your audit client. (06 marks)

- (B) In the case of audit engagement, it is in the public interest and therefore, it is required by the Code of Professional Ethics that members of audit teams and firms shall be independent of audit client.

You are required to:

State four(04) circumstances / relationships that can be recognized as possible threats to independence.

(04 marks)

(Total 10 marks)

Question 07

- (A) **Ranga** is an audit senior at **YTR Associates**, an audit firm and he is planning the statutory audit of **Ben (Pvt) Ltd.** for the year ended 31st December 2020. Extracts from the audit plan and working papers of trade receivables are stated below:

- There were only 5 customers with large balances.
- Auditor has assessed that the risk of material misstatement is high on existence of trade receivable.
- Auditor expects responses only if confirming party disagrees with the information provided in the balance confirmation request. Other than that no other substantive audit procedures were performed over the existence of trade receivables.
- CEO requested auditor to not to send a letter to confirm the balance of a nominated customer.

You are required to:

- (a) **Explain** two(02) weaknesses in the external confirmation process followed by the auditor.

(04 marks)

- (b) **State** two(02) actions that **Ranga** can perform on the request made by the CEO.

(02 marks)

- (B) The auditor performs audit procedures on subsequent events in an audit of financial statements. As a part of the procedures, the inquiries are made from the management and those charged with governance.

You are required to:

Identify four(04) such inquiries an auditor may make from the management and those charged with governance.

(04 marks)

(Total 10 marks)

End of Section B

SECTION C

(Total 50 marks)

Question 08

(A) **Bio In One (Pvt) Ltd. (“BIO”)** is engaged in manufacturing of coconut powder for the local market. It was established before six (06) years ago and the initial operations were conducted in a small scale. Presently the company has been expanded with more than 50 wholesale customers including supermarkets, direct distributors and agents. 120 employees work in the manufacturing plant. However, **BIO** does not have a formally set up key business processes.

- The Managing Director’s spouse, **Mrs. Nilani** involves in invoicing and following up on outstanding collection process, but she does not have a background on accounting or finance.
- The Managing Director (MD) requested your professional accounting firm to conduct an internal control assessment. The partner-in-charge of your accounting firm noted the following:
 - The financial statements have not been prepared by the company for last 3 years.
 - Material purchases records and supporting documents for the payments made are not systematically maintained. Managing Director who is the main shareholder personally involves in procuring the materials and other supplies.
- During the discussion with the client, the partner-in-charge has explained the MD about the importance of having a proper internal control system for **BIO** with proper record keeping. The MD wants the firm to help them in setting up a process of internal control system. Further, it was decided to have a computerized system with trained staff.
- As the first step, the partner-in-charge was requested by the MD to do an awareness presentation to MD, Mrs. Nilani and two managers about the proposed internal control system for **BIO**. As **BIO** is going to use a computerized system, the partner was also requested to explain about IT general controls and application controls.

You are required to:

- (a) **Identify** three(03) internal control weaknesses in **BIO**. (03 marks)
- (b) **Explain** the following with a related example each which could be applicable to **BIO** with a proper internal control system:
- Operational controls.
 - Finance controls.
 - Compliance controls. (06 marks)
- (c) **List** four(04) key business processes that you need to separately identify at the **BIO**. (04 marks)
- (d) **Differentiate** the purpose of IT General Controls and IT Application controls. (03 marks)

(B) One of your friend stated that if the company has a sound internal control system, risk of fraud and errors could be eliminated.

You are required to:

- (a) **Discuss** the validity of the statement made by your friend on internal control system. (04 marks)
- (b) **Explain** what is meant by a system of internal control. (03 marks)
- (c) **State** two(02) components of internal control system as per COSO. (02 marks)
- (Total 25 marks)

Question 09

(A) You are the senior in charge of the statutory audit of **Bell (Pvt) Ltd. ("Bell")** for three years continuously. **Bell** engages in manufacturing of tyres for vehicles and entire production is exported to Europe. The following details relating to the audit engagement is extracted from audit planning memo and related working papers prepared by your senior, **Kasun** for the financial year ended 31st December 2020:

Bell is a family owned business and its current ownership and governance is as follows:

Name	Ownership	Remarks
Mr. Mahela Perera	60%	Director
Mrs. Ashini Perera	30%	Director and spouse of Mr. Mahela Perera
Ms. Rose Perera	10%	Director and daughter of Mr. and Mrs. Mahela Perera

- During the year, **Bell** has recruited a CEO.
- During the year, **Mr. Mahela Perera** has acquired 30% shares held by **ABC (Pvt) Ltd.** in **Bell**.
- A new production plant has been built incurring a cost of Rs. 250 million. As a result of this, the production capacity has been increased by 30%.
- **Bell's** sales revenue for the year was decreased by 25% compared to previous year mainly due to COVID-19 impact.
- **Bell** has achieved a profit margin of 15% continuously in the past and, it was dropped to 10% in the current year.
- The CEO's bonus is determined based on the achievement of pre-determined Key Performance Indicators (KPIs), such as sales and profits.
- The letter of engagement of the last year was used for the current year audit as well.
- Overstatement of sales is considered as a risk of fraud.
- **Kasun** has computed the materiality for the financial statements as a whole based on the total assets (5% of total assets).

You are required to:

- (a) **Identify** four(04) areas that need special attention in performing audit procedures at **Bell**. (04 marks)
 - (b) **State** three(03) conditions that should be considered by the auditor to revise the terms of the letter of engagement. (03 marks)
 - (c) **Identify** three(03) areas where auditor should exercise professional judgment in planning and performing an audit. (03 marks)
 - (d) **Explain** the term “Significant Risk” with an example already identified by **Kasun** in respect of the audit of **Bell**. (04 marks)
 - (e) **List** four(04) audit procedures that **Kasun** would perform when auditing the sales of **Bell**. (04 marks)
- (B) Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future.

You are required to:

- (a) **State** three(03) examples for financial indicators that may cast significant doubt on the entity’s ability to continue as a going concern. (03 marks)
 - (b) **State** four(04) audit procedures to be performed by the auditor when events or conditions related to going concern are identified. (04 marks)
- (Total 25 marks)

End of Section C

ACTION VERBS CHECK LIST

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

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

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

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