



**ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA**  
**LEVEL III EXAMINATION - JULY 2022**  
**(303) FINANCIAL CONTROLS & AUDIT**

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

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

20-08-2022  
Afternoon  
[01.45 – 05.00]

- (2) **All questions should be answered.**

No. of Pages : 08

No. of Questions : 09

- (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**

Shown below are the implications of recent changes in external environmental factors on the principal business activities of **Agro Life (Pvt) Ltd.** which is engaged in cultivating and selling vegetables:

- (1) Import and distribution of chemical fertilizer business was ceased due to the policy decision taken by the government to ban import of chemical fertilizer to the country.
- (2) Demand for carbonic fertilizer has increased in the country. However, adequate quantities could not be imported due to lack of US Dollars (USD) in the country.
- (3) Cultivation and selling of carbonic vegetables segment is very lucrative due to many customers becoming health conscious and demanding organic food even at a higher price.
- (4) Online platforms are popularized among customers when ordering items.
- (5) Change in climate affects adversely to agricultural industry.

**You are required to:**

**Assess** the impact of the above factors of **Agro Life (Pvt) Ltd.** for external environmental factors / forces (PESTEL). (05 marks)

## Question 02

A risk management framework is the structured process used to identify potential threats to an organization and define the strategy for eliminating or minimizing the impact of these risks. The evolution of the information technology has influenced every aspect of a business organization. In today's context, information technology facilitates the automation of the processes starting from risk identification and ending with monitoring.

**You are required to:**

- (a) **State** three(03) opportunities / benefits of using a risk management framework. (03 marks)
  - (b) **Identify** two(02) risk management tools connected with information technology. (02 marks)
- (Total 05 marks)

## Question 03

The Board of Directors of **XY (Pvt) Ltd.** (*"the company"*) appointed **Devaka Associates**, a firm of Chartered Accountants to perform the audit of the company's financial statements for the year ended 31<sup>st</sup> March 2022 prepared in accordance with SLFRS for SMEs. **Devaka Associates** performs the audit in accordance with Sri Lanka Auditing Standards and is planning to provide audit report with the opinion by 25<sup>th</sup> May 2022.

**You are required to:**

- (a) **Define** the term "Assurance Engagement". (02 marks)
  - (b) **Identify** three(03) key elements of an assurance engagement with reference to the above engagement. (03 marks)
- (Total 05 marks)

## Question 04

An audit firm shall establish and maintain a system of quality control that includes policies and procedures. Acceptance & continuation of client relationships and monitoring are two elements of a system of quality control.

**You are required to:**

- (a) **State** two(02) requirements to be implemented by an audit firm for acceptance and continuation of client relationships. (02 marks)
  - (b) **Explain** two(02) activities included under the monitoring. (03 marks)
- (Total 05 marks)

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*End of Section A*

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## **SECTION B**

(Total 30 marks)

### **Question 05**

You are the senior in-charge of audit of **ABC Group PLC** for the year ended 31<sup>st</sup> March 2022. Group consists of five local subsidiaries and a joint venture. One of the local subsidiaries was acquired during the year. Entities within the group operate in diverse range of business activities including manufacturing of consumer goods, retail, leisure, real estate developments, investment and financing.

Majority of the companies within the group transact with each other in their normal course of businesses. All financing and investing activities of the group are handled by the parent company.

At the initial team discussion, engagement partner stressed that the audit team should focus on related party transactions & disclosures and ensure that sufficient and appropriate audit evidences are gathered. Newly joined team member sought your support to understand on the above message of the engagement partner.

**You are required to:**

- (a) **Explain** what is meant by sufficiency and appropriateness of audit evidences. (03 marks)
  - (b) **Explain** the relationship between risk of material misstatement and sufficient & appropriateness of audit evidences. (03 marks)
  - (c) **Identify** four(04) audit procedures that the audit engagement team of **ABC Group PLC** can perform regarding the related party transactions. (04 marks)
- (Total 10 marks)

### **Question 06**

**Himali** joined an audit firm after completing her level III professional examination. An orientation program was conducted to the newcomers by the training division of the audit firm and **Himali** was given the opportunity to refer some specimen audit working papers and audit reports for the training purposes. She noted in one of the auditor's report that there was a paragraph called "Emphasis of a Matter".

**You are required to:**

- (a) **State** four(04) elements of the Auditor's Report. (04 marks)
  - (b) **Explain** what is meant by "Emphasis of a Matter paragraph" included in the Auditor's Report. (03 marks)
  - (c) **Explain** an instance in which the auditor expresses an adverse opinion in his report on the Financial Statements. (03 marks)
- (Total 10 marks)

## Question 07

You are an audit senior at **PTS Associates**, a firm of Chartered Accountants and currently involve in the audit of **Jayasena (Pvt) Ltd. (JPL)**.

**Mr. Peterson**, who is a senior partner of the firm is the engagement partner of the audit of **JPL** since it became an audit client of **PTS** in 2008. At the audit meeting, **Mr. Peterson** mentioned that **JPL** is a long-lasting key client of the firm contributing approximately 20% of the firm's revenue through audit and non- audit services. He also mentioned that he has maintained an exceptionally good close relationship with this client and the same should be maintained by the team at any cost. **Thilini** is the recurring audit manager of this engagement for last two years. **JPL** offered her the vacant post of accountant and **Thilini** accepted it.

You were assigned to the engagement on review the impairment of financial assets of **JPL**. At the initial meeting you had with Finance Manager to obtain related clarifications, he mentioned:

“I suggest you to liaise with **PTS** finance advisory team to obtain all required clarifications as he has no idea about the related working and those were prepared by the said team as a separate engagement at a quite high fee.”

**You are required to:**

- (a) **Assess** three(03) threats to compliance with the fundamental principles of ethics with reference to above facts. (06 marks)
  - (b) **State** four(04) firm wide safeguards to be implemented by **PTS** to minimize the threats identified in (a) above. (04 marks)
- (Total 10 marks)

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*End of Section B*

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## **SECTION C**

(Total 50 marks)

## Question 08

(A) **Crown (Pvt) Ltd. (Crown)**, which is a three-star hotel with 61 rooms. **Mr. Nihal** is the chairman of the company and requested your audit firm to conduct their annual audit for the year ended 31<sup>st</sup> March 2022. **Mr. Nihal** has already communicated to the previous auditors about the change of the auditor and previous year audited accounts have been provided to you.

Due to COVID-19 pandemic, the company has operated only for six (06) months during the year. However, minimum maintenance activities have been carried out during the non-operating period.

The following Income Statements summaries are made available to you: (Rs.'000)

For the year ended 31 <sup>st</sup> March	2022 (Draft)	2021 (Audited)	2020 (Audited)
Revenue	10,224	17,370	122,624
Cost of Sales	(8,970)	(14,650)	(70,122)
<b>Gross Profit</b>	<b>1,254</b>	<b>2,720</b>	<b>52,502</b>
Distribution Expenses	(322)	(455)	(4,166)
Admin Expenses	(9,475)	(11,127)	(21,362)
Finance Expenses	(3,165)	(3,422)	(3,070)
<b>Net Profit / (Loss) Before Tax</b>	<b>(11,708)</b>	<b>(12,284)</b>	<b>23,904</b>
Income Tax Expenses	0	0	(1,060)
<b>Net Profit / (Loss)</b>	<b>(11,708)</b>	<b>(12,284)</b>	<b>22,844</b>

During the initial discussion, **Mr. Nihal** has informed you that, Finance Manager of **Crown** left 6 months back and the vacant position was not replaced as the Accounts Executive, **Chamila** is capable in handling the functions. Further, some payments vouchers and supporting documents were not properly maintained by the company.

As the audit senior of this audit, you are required to prepare the overall audit strategy for the audit of **Crown** and the detailed audit plan thereafter.

**You are required to:**

- (a) **Identify** five(05) matters that should be considered in preparing the overall audit strategy of the **Crown (Pvt) Ltd.** (05 marks)
  - (b) **List** five(05) specific documents relating to **Crown (Pvt) Ltd.** that you should collect to maintain the permanent audit file. (05 marks)
  - (c) **State** four(04) reasons why materiality is important for an auditor. (04 marks)
  - (d) **Identify** four(04) written representations that you may obtain in respect to the audit. (04 marks)
- (B) Listed below are concerns of two junior team members relating to expense validation of **Crown**:
- Original supporting documents such as invoices were neither attached to payment vouchers nor available for verification upon request for most of the payments relating to entertainment expenses. Hence related audit work could not be duly completed.
  - For the month of March 2022, no electricity, telephone, and water bills were available, and amounts equal to last month's actual bills were debited to those expense accounts.
  - Charging of depreciation on furniture and equipment has been omitted for 3 months and **Chamila** was unable to provide proper explanation on this.

Considering the above concerns of the Juniors, you mentioned control deficiencies that they have identified should be reported in auditor's communications with those charged with governance.

**You are required to:**

- (a) **Explain** what is meant by the deficiencies in internal controls. (03 marks)
- (b) **Assess** the impact of above deficiencies in internal controls of **Crown** based on the concerns raised by two juniors. (04 marks)
- (Total 25 marks)

## Question 09

(A) **Jaliya** is one of your friends, who owns 40% shares of his family own business, **Jaliya Batiks (Private) Ltd. (Jaliya Batiks)**. He proudly told you that he converted his father's sole proprietorship into a private company during the last year. His father owns balance 60% of shares and works as the chairman of the company.

**Jaliya** is planning to expand business and he seeks your co-operation to implement a proper internal control system. Listed below are further information disclosed by **Jaliya** relating to his current business activities:

- Both he and his father are directly involved in operations of the business mainly in production.
- There are about 200 employees and 2 executive staff who take care of all office work including record keeping, salary payments and accounting functions. Majority of the employees is from his village and well-known people to his father.
- His father gives utmost importance to integrity and ethical values and lead those values among employees by example. He also grants pay increases and recognition to hard working talented employees. However, his father's practice is to work based on trust and hence has not initiated any formal process or controls over the key business activities.
- The chairman directly takes the specific bulk orders and ensure those are delivered purely based on his memory.
- **Jaliya** believes that the current organizational structure is good enough to cater the nature and size of his current business.
- However, he doubts about ongoing business expansion activities due to ever-growing competition specially through internet-based sales systems introduced by key competitors.

**You are required to:**

- (a) **Recognize** the elements of internal control system (as per COSO framework), that appear to be weak in **Jaliya Batiks** based on the above facts. (05 marks)
- (b) **Explain** two(02) reasons why a strong internal control system is important for **Jaliya Batiks**. (04 marks)
- (c) **Identify** two(02) inherent limitations of an internal control system. (02 marks)

(B) **Jaliya** mentioned the below facts relating to cash management process seeking some process improvement guidance from you.

- Cash and cheques relating to retail or wholesale items are collected by one of the two executives. All such sales are made at company's main warehouse adjacent to factory.
- Following the guidance of his father, they generally note down amounts of cash received in a cash book while cheques collected are just kept in the drawer until those are banked by one of the executives.
- Cash collected from sales are used for day-to-day expenses and balance together with cheques are usually deposited at the end of the week.
- At any given point company carries significant amount of cash collections set aside for operating expenses, either in hand or in savings accounts.
- As bank account balance may never tie up with the cash book balance, due to delays in realizing cheques deposited and executives take no further actions upon receipt of bank statements.

Further, **Jaliya** wishes to implement a tailor-made system with three modules namely; General ledger, inventory, and creditors as an initial step to computerize key processes of **Jaliya Batiks**.

**You are required to:**

- (a) **Identify** five(05) internal control weaknesses in the above cash management process of **Jaliya Batiks**. (05 marks)
- (b) **State** a recommendation each to overcome the above weaknesses. (05 marks)
- (c) **List** two(02) general IT controls with an example each, that **Jaliya** can consider in implementing the above information systems. (04 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.