



Association of Accounting Technicians of Sri Lanka

AA3 Examination - January 2020

**Suggested Answers
(AA34)**

**PROCESSES, CONTROLS AND AUDIT
(PCA)**

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THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA
EDUCATION AND TRAINING DIVISION

AA3 Examination - January 2020
(AA34) Processes, Controls and Audit

SUGGESTED ANSWERS

SECTION – A

Four (04) compulsory questions
(Total 20 marks)

Suggested Answers to Question One:

Chapter 01- Business Environment

- a) 1. Limited Liability Companies
2. Partnership
- b) Economic Factors
1. Inflation in the country
 2. Fluctuations in Foreign Exchange Rates
 3. Interest Rates
 4. Tax policy of the government
 5. Government regulations on import
 6. Demand and Supply factors
 7. Global Economic Factors

(02 marks)

(03 marks)

(Total 05 marks)

Suggested Answers to Question Two:

Chapter 07- Audit Evidence – Further Consideration

Financial events

- Net liability or net current liability position
- Fixed-term borrowings approaching maturity without realistic prospect of renewal or repayment

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- Indications of withdrawal of financial support by creditors
 - Negative operating cash flows (historical or prospective)
 - Adverse key financial ratios
 - Substantial opening losses or significant deterioration in the value of assets used to generate cash flows
 - Arrears or discontinuance of dividends
 - Inability to pay creditors on due dates
 - Inability to comply with term of loan agreements
 - Change from credit to cash-on-delivery transactions with suppliers
 - Inability to obtain financial for essential new product development or other essential investments

Operating events

- Management intentions to liquidate or cease operations
- Loss of key management without replacement
- Loss of a major market, key customers, license, or principal suppliers
- Labour difficulties
- Shortage of important suppliers
- Emergence of high successful competitors

(Total 05 marks)

Suggested Answers to Question Three:

Chapter 07- Audit Evidence – Further Consideration

- (a) • Related party transactions have taken place without charge.
- Related party transactions are not self-evident to the auditors.
 - Transactions are with the party that the auditors could not reasonably be expected to know as a related party.
 - Active test have been taken by management to conceal either the full terms of transaction, or that a transaction is, in substance, with a related party.
 - The cooperate structure is complex.
- (02 marks)*
- (b) • Inquire with management and those charged with governance.
- Review of accounting records for large or unusual transactions.
 - Review confirmations of loans receivables, payables and confirmations from the banks.
 - Review investment transactions.
 - Inquire the names of all pension and other trusts established for the benefit of employees and the names of their management and trustees.
 - Inquire as to the affiliation of the directors and officers with other entities.

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- Review the register of the interest in shares.
 - Inquire with other auditors currently involved in the audit, or predecessor auditors, as to their knowledge of additional related parties.
 - Review the entity's tax returns.
 - Review minutes of meeting of shareholders.
 - Review invoices and correspondence from lawyers for indications of the related parties or related parties or related party transactions.
 - Obtain written representation from the management from the management and those charged with governance about completeness of details furnished to auditor in terms of related parties and transactions with them and disclosure is appropriately made in the financial statements.

(03 marks)

(Total 05 marks)

Suggested Answers to Question Four:

Chapter 10- Audit Quality

(a) Review

This refers to the inspection of work done by engagement members by more senior members of the same engagement. This includes ensuring that;

- The work has been performed in accordance with the audit program.
- The work performed and the results obtained have been adequately documented.
- All significant audit matters have been resolved or are reflected in audit conclusions.
- The objectives of the audit procedures have been achieved; and
- The conclusions expressed are consistent with the result of the work performed and support the audit opinion.

(02 marks)

(b) Elements of Quality control

- Leadership responsibilities for quality within the firm
- Human Resources
- Engagement Performance
- Monitoring
- Acceptance and continuance of client relationships
- Relevant ethical requirements

(03 marks)

(Total 05 marks)

End of Section A

Three (03) compulsory questions
(Total 30 marks)

Suggested Answers to Question Five:

(a)

Chapter 06 - Audit Evidence

Sufficiency related to quantity of evidence. The quantity of audit evidence required is affected by the level of risk in the area being audited. It is also affected by the quality of evidence obtained. If the evidence is of high quality, the auditors may need less than if it were poor quality.

Appropriateness Relates to the quality or reliability of evidence.

(04 marks)

(b)

Chapter 04 - Assurance Engagements and Related Services

Key requirements should be performed when accepting and continuing the assurance engagement

1. Ethical and quality control requirements

- The practitioner should,
 - Comply with the requirements of Parts A and B of Code of Ethics for professional Accountants (the code)
 - Comply with Code of Ethics issued by the AATSL
 - Implement quality control procedures

2. Engagement acceptance and continuance

- Practitioner should consider,
 - Whether the subject matter is the responsibility of a party other than the intended users or the practitioner
 - Those persons who are to perform the engagement collectively possess the necessary professional competencies

3. Planning and performing engagement

- Main matter to be considered when planning and performing an engagement:
 - The term of the engagement
 - The characteristics of the subject matter and the identified criteria
 - Possible source of evidence
 - The practitioner's understanding of the entity and its environment

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- Identification of intended users and their needs
 - Personal and expertise requirements, including the nature and extent of experts' involvement
4. **Assessing the appropriateness of the subject matter**
- An appropriate subject matter;
 - Should be identifiable
 - Can be evaluated against identified criteria
 - Sufficient and appropriate audit evidence can be obtained.
5. **Assessing the suitability of the criteria**
- The practitioner should have preliminary knowledge of the engagement and that the criteria to be used are suitable.
6. **Materiality and assurance engagement risk**
- The practitioner should consider Materiality and assurance engagement risk when planning and performing an assurance engagement.
7. **Obtaining evidence**
- The practitioner should obtain sufficient appropriate evidence on which to base the conclusion. For that, practitioner should;
 - Obtain an understanding of the subject matter
 - Assess the risk of material misstatements
 - Response to assessed risk
 - Perform further audit procedures clearly linked to the identified risks
 - Evaluate the sufficiency and appropriateness of evidence
8. **Documentation**
- The practitioner should document matters that are significant in providing evidence that supports the assurance report and the engagement was performed in accordance with SLSAE (Sri Lanka Standard on Assurance Engagement).
9. **Preparing the Assurance Report**
- The practitioner should conclude that sufficient appropriate evidence has been obtained to support the conclusion expressed in the assurance report.
 - The assurance report should be in writing and should contain a clear expression of the practitioner's conclusion about the subject matter.

(06 marks)

(Total 10 marks)

Suggested Answers to Question six:

Chapter 08- Audit Reporting

(A) (a) The company should have depreciated from 1st October to 31st December 2019, since the asset was available for use by the company.

The depreciation charge for the 3 months is Rs.1Mn. It is not exceeding the materiality of Rs. 1.7 Mn. Therefore, it is not a material misstatement.

The company shouldn't have capitalized borrowing cost from 1st October, since construction was completed. Rs. 1.5 million need to be charged to P&L. However, the amount is not exceeding the materiality of Rs.1.7 million. Therefore, it is not material misstatement.

However, if we consider both misstatements together, then it is material to the financial statements. If management is not willing to rectify, then audit opinion need to be modified.

(06 marks)

(b) **Modified opinion**

Nature of matter	Material but not pervasive	Material and pervasive
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

(04 marks)

(Total 10 marks)

Suggested Answers to Question seven:

Chapter 09-Ethical requirements affecting an audit of financial statements

(A) (a) Procedures to follow when replacing the existing auditor

- At least twenty working days' written notice of a proposal to do so to be given the existing auditor of the company.
- The auditor should be given a reasonable opportunity to make representations to the shareholders on the appointment of another person, either in writing or by the auditor or his representative speaking at a shareholder meeting.

(04 marks)

(b) Procedure to follow after accepting the appointment as the Statutory Auditor

- Ensure that the outgoing auditor's removal or resignation has been properly conducted in accordance with national legislation.

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- Ensure that the new auditor's appointment is valid. The new auditor's should obtain a copy of the resolution passed at the general meeting appointing them as the company auditors.
 - Setup and submit a letter of engagement to the Directors of the company.

(04 marks)

(B) Situation where profession accountants may be required to disclose confidential information

- When disclosure is permitted by law and is authorized by the client or the employer
- When disclosure is required by law, for example production of documents or other provisions of evidence on the course of legal proceedings or investigations.
- When there is a professional duty or right to disclose , (e.g. to comply with the quality review of a member body or professional body,)

(02 marks)

(Total 10 marks)



End of Section B

Two (02) compulsory questions
(Total 50 marks)

Suggested Answers to Question Eight:

Chapter 02-Governance, Risk and compliance

- (a) Guidelines to followed by Directors
- Every public company should be headed by an effective board, which should not direct, lead and control the company
 - The chairman's role in preserving good Corporate Governance is crucial. As the person responsible for running the board, the chairman should preserve order and facilitate the effective discharge of the Board functions
 - The board should ensure the availability within it of those with sufficient financial acumen and knowledge to offer guidance on matter of finance
 - It is preferable for the Board to have a balance of Executive and Non-Executive Directors such that no individual or small group of individuals can dominate the Board's decision taking
 - There should be a formal and transparent procedure for the appointment of new Directors to the Board
 - All Directors should be required to submit themselves for re-election at regular intervals and at least once in three years
 - Board should periodically appraise their own performance in order to ensure that Board responsibilities are satisfactorily discharge
 - Shareholders should be kept advised of relevant details in respect of Directors
 - The board should be required, at least annually, to assess the performance of the CEO

(04 marks)

- (b) Committees to be appointed
- 1) Remuneration committee
 - 2) Audit committee
 - 3) Related party transaction review committee

(02 marks)

(c) Strengths of the procurement process

- It is having and maintaining a registered suppliers' list.
- Pre-determined / approved prices available in the system.
- Department heads raise items request notes when there's a necessity of items
- Departmental heads approve items request notes.
- Limits are set to approve purchase orders.
- GRN is raised by the stores clerk and entered into the system on the same day.
- At the time of preparing the payment voucher, the supplier invoice is matched with PO and GRN.
- There is an upper limit of cheque signature.
- All capital nature items are purchased with the approval of the Board of Directors.

(05 marks)

(d)

Control	Objective
It is having and maintaining a registered suppliers' list	This will ensure that items will be purchased through a reliable supplier
Pre-determined / approved prices available in the system	This will ensure that there won't be any discrepancies with the prices
Department heads raise items request notes when there's a necessity of items	There will be not be any unnecessary purchases and there is a responsible person for every item requested.
Departmental heads approve items request notes	There is a responsible person for every item requests
Limits are set to approve purchase orders	There is a control on the purchases.
GRN is raised by the stores clerk and entered into the system on the same day.	This will mitigate the fraud risk.
At the time of preparing the payment voucher, the supplier invoice is matched with PO and GRN.	This will ensure that the item is received to the hotel in the expected condition.
There is an upper limit of cheque signature.	This will ensure that the items ordered and the received items are same and the received items are same and the payment is as per the supplier's invoice
All capital nature items are purchased with the approval of the Board of Directors.	This will mitigate the risk of Fraud

(05 marks)

(e)

Chapter 03-Business Processes and Internal Controls
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Elements of control environment

- Communication and enforcement of integrity and ethical values
- Commitment to competence
- Participation by those charged with governance
- Management's philosophy and operating style
- Organization structure
- Assignment of authority and responsibility
- Human resources policies and practices

Control activities to be established

- 1) Segregation of duties
- 2) Physical controls
- 3) Authorization and approval
- 4) Management controls
- 5) Supervision controls
- 6) Organization controls
- 7) Arithmetical and accounting controls
- 8) Personal Controls

(05 marks)

(f) General controls to prevent unauthorized amendments

- Segregation of duties
- Limited access to central computer by locked doors key pads
- Firewalls-virus checks on software. Use of antivirus software and policy prohibiting use of non-authorized programs or files
- User identification controls such as password protection of programs so that access is limited to computer operational staff
- Back-up copies of programs being taken and stored in other locations

Application controls to control over accuracy of inputs

- 1) Programs to check data fields (for example value, reference number, date) on input transaction for plausibility
- 2) Digit verification
 - Reasonableness test

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- Character checks
 - Necessary information
 - Permitted range
- 3) Manual scrutiny of output and reconciliation to source
 - 4) Agreement of control totals

(04 marks)

(Total 25 marks)

Suggested Answers to Question Nine:

Chapter 05-Audit Process

(a) Reasons for Proper Planning

Audits are planned to:

- Help the auditor devote appropriate attention to important areas of the audit
- Help the auditor to identify and resolve potential problems on a timely basis
- Help the auditor to properly organize and manage the audit so that it is performed in an effective manner
- Assist in the selection of appropriate team members and assignment of work to them
- Facilitate the direction, supervision and review of work
- Assist in coordination of work done by auditors of components and experts

(04 marks)

Chapter 06-Audit Evidence

(b) Source that can get the understanding of the Srina Fabrics PLC

1. Prior year working papers
2. Information from other engagements undertaken for the entity
3. Discussion among team members
4. Publications or websites from company operates(Annual reports)
5. Permanent file
6. Information from company's website
7. Inquiries from management and those charged with governance
8. Analytical procedures
9. Observation and inspection
10. Client acceptance or continuation of process

(05 marks)

(c) Areas need special attention

1. Debtors' balance
2. Inventory balance
3. Revenue recognition
4. Bonus
5. Impairment provision on debtors
6. Debtors' age analysis
7. Subsequence settlement of debtors
8. The debtor owing of Rs. 80 million since he reduced the orders significantly

(06 marks)

(d) Audit procedures for debtors balance

1. Call for confirmations from debtors.
2. Inquire management why subsequent settlements are less.
3. Adequacy of provision for bad and doubtful debtors/impairment
4. Check accuracy of impairment provision.
5. Check whether credit sales are made only for approved customers and they are within the approved limits.
6. Obtain a schedule of debtors and check individual balances agree with balance as per debtors' ledger.
7. Check a sample of sales invoices
8. Calculate debtors' collection period and compare the same with previous year

(04 marks)

(e) Types of audit procedures for obtaining the audit evidence

- **Inquiry details**

Consists of seeking information of knowledgeable persons both financial and non- financial within the entity or outside the entity. Strength of evidence depends on the knowledge and integrity of source information.

- **Observation**

Consist of looking at a procedure or process being performed by others. It is of limited use as it only confirms the procedure took place when auditor was watching.

- **Inspection**

This means that the examination of records documents or tangible assets. By carrying out inspection procedures, the auditor is substantiating information that is or should be in the financial statements. Inspection can provide evidence of existence but not necessarily about ownership or value.

- **Recalculation**

This consists of checking the arithmetical accuracy of source documents and accounting records. It is deemed to be a reliable source since work is carried out by the auditor.

- **Re-performance**

This means the auditor's independent execution of procedures of controls that were originally performed as part of the entity's internal controls.

- **External confirmation**

Audit evidence obtained as direct written response to the auditor from a third party. These are highly persuasive as these come from independent external sources.

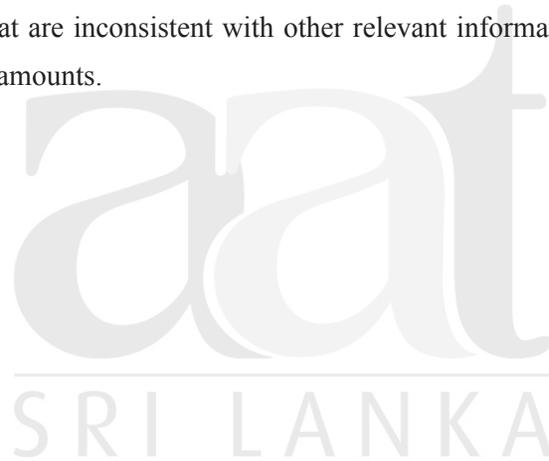
- **Analytical procedures**

This refers to evaluation of financial information through analysis of plausible relationships among both financial and non-financial data.

Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.

(06 marks)

(Total 25 marks)



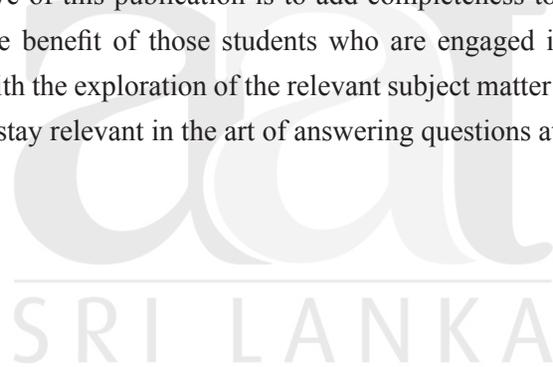
End of Section C

Notice :

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The fundamental objective of this publication is to add completeness to its series of study texts, designs especially for the benefit of those students who are engaged in self-studies. These are intended to assist them with the exploration of the relevant subject matter and further enhance their understanding as well as stay relevant in the art of answering questions at examination level.



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