



**Association of Accounting Technicians of Sri Lanka**

**Level III Examination – July 2022**

**Suggested Answers**

**(303) FINANCIAL CONTROLS & AUDIT (FCA)**

**Association of Accounting Technicians of Sri Lanka**

No.540, Ven. Muruthettuve Ananda Nahimi Mawatha,

Narahenpita, Colombo 05.

Tel : 011-2-559 669

**A publication of the Education and Training Division**

**Level III Examination - July 2022**

**(303) FINANCIAL CONTROLS & AUDIT**

**SUGGESTED ANSWERS**

(Total 20 Marks)

**SECTION - A**

*Suggested Answers to Question One:*

**Chapter 01- Business Environment and Governance Framework**

1. The government of the country has taken a policy decision to ban the import of chemical fertilizer resulting in a cessation of the Import and distribution of chemical fertilizer business. As per the PESTEL framework, this is a **Political** force which has negatively affected the company's business segment relating to import and distribution of Chemical Fertilizer.
2. Even though the demand for carbonic fertilizer has increased in the country, the adequate quantities could not be imported due to lack of US Dollars (USD). This is an **Economic** force which was resulted by the prevailing economic issues/crisis situation in the country.
3. Cultivation and selling of carbonic vegetables segment has been favorably impacted due to the changes in Customer preferences, beliefs and behaviors leading to demand more health conscious and organic food even at a premium price. These changes in Customer preferences, beliefs and behaviors can be attributed to **Social and Cultural** forces of PESTEL Framework.
4. With the advancement and widespread use of Technology, the online platforms are popularized among customers when ordering items. This is a **Technological** forces as per PESTEL framework.
5. The adverse impact of climate changes to Agricultural industry is an **Environmental** force as per PESTEL framework.

*(05 marks)*

## ***Suggested Answers to Question Two:***

### ***Chapter 02 - Risk Management Framework***

(a)

1. Asset Protection
2. Reputation Management
3. Supply Chain Risk
4. Intellectual Property Protection
5. Competitor Analysis
6. Reduce business liability
7. Helping companies create risk aware culture
8. Improving optional efficiency

***(03 marks)***

(b)

1. Basic Risk Visualization Programs
2. Social Media
3. Data Integration and Analytics
4. Data Mining
5. Open Data
6. Cyber Security
7. Artificial Intelligence

***(02 marks)***

***(Total 05 marks)***

## ***Suggested Answers to Question Three:***

### ***Chapter 04 - Assurance Engagements and Related Services***

(a)

An **assurance engagement** is an engagement in which a **practitioner** aims to obtain sufficient appropriate evidence in order to express a conclusion designed to enhance the degree of confidence of **the intended users** other than the **responsible party** about the **subject matter** information (that is, the outcome of the measurement or evaluation of an underlying subject matter against certain criteria).

***(02 marks)***

(b)

<b>Criteria</b>	Audit of the company's financial statements for the year ended March 2022.
<b>Report</b>	Opinion on the financial statements (Auditors report)
<b>Evidence</b>	Sufficient and appropriate evidence to be gathered.
<b>Subject Matter</b>	Financial information of financial statements
<b>Three party relationship</b>	Stakeholder, Devika Associates and Management (Board of Directors)

***(03 marks)***

***(Total 05 marks)***

## ***Suggested Answers to Question Four:***

<b><i>Chapter 09 - Requirements for an Audit of Financial Statements</i></b>
--

**(a)**

1. Consideration of whether the firm has the competence, capabilities, and resources to undertake a new engagement from a new or an existing client involves reviewing the specific requirements of the engagement and the existing partner and staff profiles at all relevant levels.
2. Consideration of the Integrity of the client.
3. Relevant ethical requirements should be complied.

***(02 marks)***

**(b)**

- a) An ongoing consideration and evaluation of the firm's system of quality control including, on a cyclical basis, inspection of at least one completed engagement for each engagement partner;
- b) Assigning the required level of responsibility to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility; and
- c) Ensuring that those performing the engagement or the engagement quality control review are not involved in inspecting the engagement.

***(03 marks)***

***(Total 05 marks)***

<b><i>End of Section A</i></b>
--------------------------------

***Suggested Answers to Question Five:***

(a)

***Chapter 06 - Audit Evidences***

**Sufficiency** – The measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor’s assessment of the risks of material misstatement and also by the quality of such audit evidence.

**Appropriateness** – The measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor’s opinion is based.

**(03 marks)**

(b)

***Chapter 05 - Audit Evidences***

**Risk of Material misstatement** is the risk that the Financial Statements are materially misstated. This consists of two components namely inherent risk and control risk.

There is a positive relationship between the risk of material misstatements and the audit evidence. This means if the assessed level of risk is high, the audit or needs to gather more audit evidence and vice versa. However, obtaining more audit evidence may not compensate for poor quality of audit evidence.

**(03 marks)**

(c)

***Chapter 06 - Audit Evidences***

1. Enquire of management and the directors as to whether transactions have taken place with related parties that are required to be disclosed in the financial statements
2. Review prior-year working papers for names of known related parties.
3. Review minutes of meetings of shareholders and directors and other relevant statutory records such as the register of directors' interests.
4. Review accounting records for large or unusual transactions or balances, in particular transactions recognized at, or near, the end of the financial period.
5. Review confirmations of loans receivable and payable and confirmations from banks. Such a review may indicate the relationship, if any, of guarantors to the entity.
6. Review investment transactions, for example purchase or sale of an interest in a joint venture or other entity.
7. Enquire as to the names of all pension and other trusts established for the benefit of employees and the names of their management and trustees.

8. Enquire as to the affiliation of directors and officers with other entities.
9. Review the register of interests in shares to determine the names of principal shareholders.
10. Enquire of other auditors currently involved in the audit, or predecessor auditors, as to their knowledge of additional related parties.
11. Review the entity's tax returns, returns made under statute and other information supplied to regulatory agencies for evidence of the existence of related parties.
12. Review invoices and correspondence from lawyers for indications of the existence of related parties or related party transactions.

**(04 marks)**  
**(Total 10 marks)**

### ***Suggested Answers to Question Six:***

<b>Chapter 07 - Audit Reporting</b>
-------------------------------------

**(a)**

- 1) Title
- 2) Addressee
- 3) Auditor's Opinion
- 4) Basis for Opinion
- 5) Going Concern
- 6) Key Audit Matters
- 7) Other Information
- 8) Responsibilities for the Financial Statements
- 9) Auditor's Responsibilities for the Audit of the Financial Statements
- 10) Other Reporting Responsibilities
- 11) CA Sri Lanka Membership Number of the Engagement Partner
- 12) Signature of the Auditor
- 13) Auditor's Address
- 14) Date of the Auditor's Report

**(04 marks)**

**(b)**

Auditor express an emphasis of a matter paragraph in an additional communication when;

Draw users' attention to any matter or matters other than those presented or disclosed in the financial statements that are relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

**(03 marks)**

**(c)**

The auditor expresses an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

**(03 marks)**  
**(Total 10 marks)**

## *Suggested Answers to Question Seven:*

### **Chapter 08 - Ethical Requirements**

(a)

#### **1. Self-interest threat**

JPL is a long-lasting client and the firm (PTS Associates) having undue dependence on total fees from the client approximately 20% of the firm's revenue through audit and non-audit services.

Being a member of the assurance team, Thilini is having a significant close business relationship with the assurance client JPL as she is entering into employment negotiations with the audit client Jayasena (Pvt) Ltd.

#### **2. Self-review threat**

Thilini, A member of the assurance team being, or having recently been, employed by the client JPL in the Accountant position to exert significant influence over the subject matter of the engagement.

#### **3. Familiarity threat**

Senior personnel having a long association with the assurance client and this becomes the familiarity threat.

*(06 marks)*

(b)

1. Leadership of the firm that stresses the importance of compliance with the fundamental principles.
2. Leadership of the firm that establishes the expectation that members of an assurance team will act in the public interest.
3. Policies and procedures to implement and monitor quality control of engagements.
4. Documented policies regarding the need to identify threats to compliance with the fundamental principles, evaluate the significance of those threats, and apply safeguards to eliminate or reduce the threats.
5. Documented internal policies and procedures requiring compliance with the fundamental principles.
6. Policies and procedures that will enable the identification of interests or relationships between the firm or members of engagement teams and clients.
7. Policies and procedures to monitor and, if necessary, manage the reliance on revenue received from a single client.
8. Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client.
9. Policies and procedures to prohibit individuals who are not members of an engagement team from inappropriately influencing the outcome of the engagement.

10. Timely communication of a firm's policies and procedures, including any changes to them, to all partners and professional staff, and appropriate training and education on such policies and procedures.
11. Designating a member of senior management to be responsible for overseeing the adequate functioning of the firm's quality control system.
12. Advising partners and professional staff of assurance clients and related entities from which independence is required.
13. A disciplinary mechanism to promote compliance with policies and procedures.
14. Published policies and procedures to encourage and empower staff to communicate to senior levels within the firm any issue relating to compliance with the fundamental principles that concerns them.

**(04 marks)**

**(Total 10 marks)**



***End of Section B***



***Suggested Answers to Question Eight:***

**(A)**

***Chapter 05 - Risk Assessment and Audit Process***

**(a)**

1. The vacant position of the Finance Manager was not replaced and the duties are handled by the Accounts Executive. Hence there is a risk of material misstatements due to the incapability of the staff / Lack of adequate reviews and supervision. Hence the audit team needs to be skeptical in assessing the audit evidence and the areas of misstatements in the financial statements.
2. Since Chamila is working remotely (Work from home), there is a risk of insider information being disclosed to the third parties.
3. Chamila has been working from home during this period and some payment vouchers and supporting documents have not been properly maintained. This may give rise to misappropriation of assets/ frauds.
4. Some payment vouchers and supporting documents have not properly maintained and this may lead to frauds.
5. Company has operated only six months and operated at the reduced level of operations. Hence the audit team needs to be skeptical in assessing the audit evidence and the areas of misstatements in the financial statements.
6. Operating costs and finance costs were high.
7. Identification of management plans to overcome the situation with continues situation for last two years (going concern)
8. Concerns on Industry developments.
9. Audit evidences, Results of previous audits need to be considered.
10. Reduction in the volume of operations compared to 2019.

**(05 marks)**

**(b)**

1. Legal status of the entity, Organization structure Important legal documents.
2. Industry, regulatory details within which entity operates.
3. Certificate of Incorporation, Articles of association.
4. Statutory requirements to be complied by the entity.
5. Entity's information system and internal control system documentation.
6. Complete list of books and records maintained by the Company.
7. Copies of, and extracts from, important agreements that will be of relevance from year to year.
8. Details of major fixed assets such as property.
9. Accounting schedules of continuing relevance, such as fixed assets depreciation lapsing schedules and leased asset finance cost allocation schedules.

10. Group structure and the history of investment in subsidiaries, associates and other major investments.
11. Masters of audit programmes.
12. Location in the computer disc library of word processor masters and spreadsheet layouts.

**(05 marks)**

**(c)**

1. Identify and assess the risks of material misstatements.
2. Determine the nature, timing and extent of further audit procedures.
3. Determine the amount of audit work necessary to facilitate audit efficiency and effectiveness.
4. Determine the applicability of accounting standards which normally apply only to material items.
5. Evaluate uncorrected misstatements during the audit.
6. Evaluate what level of error is likely to lead to a modified opinion.

**(04 marks)**

### **Chapter 06 - Audit Evidences**

**(d)**

1. Whether management has fulfilled its responsibility for the preparation and presentation of the financial statements as set out in the terms of the audit engagement and whether the financial statements are prepared and presented in accordance with the applicable financial reporting framework.
2. Whether management has provided the auditor with all relevant information agreed in the terms of the audit engagement and whether all transactions have been recorded and are reflected in the financial statement.
3. Whether the selection and application of accounting policies are appropriate.
4. Plans or intentions that may affect the carrying value or classification of assets and liabilities.
5. Liabilities, both actual and contingent.
6. Title to, or control over, assets, liens or encumbrances on assets and assets pledged as collateral.
7. Aspects of laws, regulations and contractual agreements that may affect the financial statements, including non-compliance.
8. All deficiencies in internal control that management is aware of have been communicated to the auditor.
9. Written representations about specific assertions in the financial statements.
10. Significant assumptions used in making accounting estimates are reasonable.
11. All subsequent events requiring adjustment or disclosure have been adjusted or disclosed.
12. The effect of uncorrected misstatements is immaterial, both individually and in aggregate.

13. Management has disclosed the results of management's assessment of the risk that the financial statements may be materially misstated as a result of fraud.
14. Whether Management has disclosed all information in relation to fraud or suspected fraud involving management, employees with significant roles in internal control, and others where fraud could have a material effect on the financial statements.
15. Whether Management has disclosed all information in relation to allegations of fraud or suspected fraud committed by employees, former employees, analysts, regulators or others.
16. Whether Management has disclosed all instances of non-compliance or suspected non-compliance with laws or regulations.

(04 marks)

(B)

### **Chapter 05 - Risk Assessment and Audit Process**

(a)

Deficiency in internal control exists when a control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis or a control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is missing.

(03 marks)

(b)

- There is a control deficiency due the fact that payments are made without checking the supporting documents.
- No periodical reviews has been made on the financial statements. Also, the depreciation for the year has been omitted from the Financial Statements.

(04 marks)

(Total 25 marks)

### **Suggested Answers to Question Nine:**

#### **Chapter 03 - Internal Control Systems and Business Process**

(A)

(a)

##### **1. Control Environment**

This refers to the culture of the organization and its attitude to risk. A risk awareness culture is created by the leader of the organization, who should provide an example to all other employees. The effectiveness of an internal control system depends on the attitude to the risk and risk awareness of the people in it. Also, the control environment includes the governance and management function of an organization.

- Commitment to competence – Competent employees are rewarded
- Organization structure – Jaliya believes that the existing organizational structure is sound enough to cater the nature and size of his current business

- Human resources policies and practice – Jaliya relies the staff and keeps the trust
- Ethical values – Chairmen lead by example relating to the integrity and ethical values

## 2. Risk Assessment

This refers to the identification, analysis and management of uncertainty facing the organization. Risk assessment focuses on uncertainties in meeting the organization's financial, compliance, and operational objectives. The risk assessment process forms the basis for how management determines the business risks to be managed. These processes will vary depending on the nature, size and complexity of the organization.

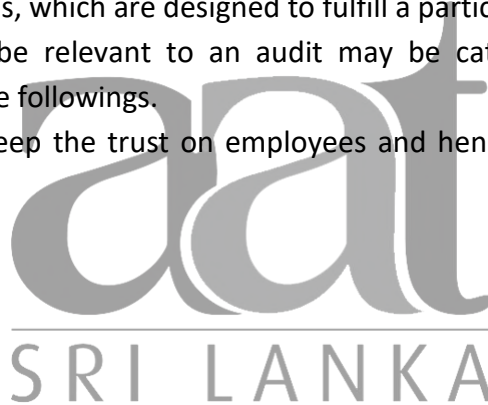
The company does not concern on the new developments or expansion from the current level. Also, it does not concentrate or eager to manage uncertainties face by the company or to compete with rivals.

## 3. Control Activities

These are the internal controls, which are designed to fulfill a particular objective. Generally, Control activities that may be relevant to an audit may be categorized as policies and procedures that pertain to the followings.

The management is highly keep the trust on employees and hence do not follow controls procedures such as;

- Segregation of duties
- Physical controls
- Supervision controls
- Organization controls



## 4. Information and communication

Based on the stated facts Jaliya Batik lacks process of capturing and exchanging the information needed to conduct, manage, and control the company's operation. Most of the business-critical information are by hearted by chairman. ( ex: details of bulk sale orders)

## 5. Monitoring

Monitoring refers to the assessment of the quality of internal control. Absence of any formal processes and controls, it is obvious monitoring element is also missing in Jaliya Batik.

**(05 marks)**

**(b)**

### 1. Reliability of Financial Reporting

- It is the responsibility of management to prepare financial statements to meet the common use of most users. Therefore, financial statements need to be reliable but do not require to provide all information that users may need to make economic decisions.
- Management also has a legal responsibility to ensure that information is fairly prepared in accordance with requirements such as Generally Accepted Accounting Principles (GAAPs) & Sri Lanka Accounting Standards.

- The above requires good internal controls to be introduced over financial reporting.

## 2. Effectiveness and Efficiency of operations

- Controls with an organization are also meant to encourage efficient and effective use of resources, including personnel, to optimize the company's goals.
- An important part of these controls is accurate information for internal decision making. A wide variety of information is used for making critical business decisions.
- Another important part of effectiveness and efficiency is safeguarding assets and records. The physical assets of the company can be stolen, misused or accidentally destroyed unless they are protected by adequate controls.

## 3. Compliance with applicable laws and regulations

- There are many laws and regulations that organizations are required to follow which are directly and indirectly related to accounting. Compliance with these laws and regulations are vital for the functions of an organization and noncompliance of certain laws may affect the going concern ability of the organization.

*(04 marks)*

**(c)**

**Inherent Limitations:** Controls may not be implemented as required. Therefore, even a well-designed control may not be able to achieve its objectives due to operational ineffective.

1. Controls may not be well designed.
2. Controls may not be implemented as required. Therefore, even a well-designed control may not be able achieve its objectives.
3. Continue changes in operational risks. As a result of the pre designed controls may fail to address new risks.
4. Cost of designing and implementing controls does not justify the benefits delivered from those controls.
5. Poor risk awareness culture within the organization. Directors should take the leadership to implement a culture which values controls over the processes of the organization
6. Non routine transactions are not covered. Most internal controls tend to direct at routine transactions rather than non-routine transactions.
7. Human errors - Even if internal controls are well designed, there can be implementation break down. Personnel may misunderstand instructions. They may make judgmental mistakes or they may commit error due to carelessness, Distraction or fatigue.

*(02 marks)*

**(B) (a) & (b)**

	<b>(a) Control weaknesses</b>	<b>(b) Recommendations</b>
1)	Cash and cheques are not banking promptly	Cash and cheques should be banked promptly , during the same day or earliest of the following date
2)	The collections are used for day-to-day expenses	The payments should be done through cheques for better control. Petty cash impressed system need to be used for minor payments
3)	Keeping cash or savings account balance to make the payments	Money should not be kept in hand. The excess funds should be deposited in a high return deposit rather than in a savings account
4)	Tallying the bank account balance and cash book balance	The bank reconciliations need to be prepared at each moth end or each week end depend on the transactions of the account
5)	Collection of cash and cheques done by one of the two executives	Cash and cheques should be accepted by the Cashier/ a specified person and need to entrust the responsibility to that person.
6)	Not maintaining a register to record the collections	A register should be maintained and ensure that cash and cheques are deposited in the bank account without delay.
7)	It appears cash in hand is not considered for investing in optimal income sources.	Cash in hand should be considered for investing temporary/ short term investments such as treasury bonds and in demand deposits.
8)	Bank reconciliations are not prepared.	Monthly bank reconciliations should be prepared and reviewed.
9)	It appears no receipts are issued once cash or cheques are received.	Receipts should be issued for all collections and receipts book with pre-printed serial numbers should be used.

**(05 marks)****(05 marks)**

(c)

Development of Computer Application	<ul style="list-style-type: none"><li>▪ Standard over systems design, programming and documentation</li><li>▪ Approval by computer users and Management</li><li>▪ Segregation of duties so that those responsible for design are not responsible for testing</li><li>▪ Training of staff in new procedures and available of adequate documentation</li></ul>
Development of Computer Applications/ Prevention or detection of unauthorized changes to programs	<ul style="list-style-type: none"><li>▪ Segregation of duties</li><li>▪ Password protection of programs so that access is limited to computer operation staff</li><li>▪ Restricted access to central computer by locked doors.</li><li>▪ Virus check on software. Use of anti-virus software and policy prohibiting use of non-authorized programs or files</li><li>▪ Back-up copies of programs being taken and stored in other locations</li></ul>
Testing and documentation of program changes	<ul style="list-style-type: none"><li>▪ Complete testing procedures</li><li>▪ Documentation standards</li><li>▪ Approval of changes by computer users and management</li><li>▪ Training of staff using programme</li></ul>
Controls to prevent unauthorized amendments to data files	<ul style="list-style-type: none"><li>▪ Physical security over remote terminals</li><li>▪ Limited access to authorized personnel</li><li>▪ Firewalls</li><li>▪ User identification controls such as passwords</li><li>▪ Encryption of Data</li></ul>
Controls to ensure continuity of operations	<ul style="list-style-type: none"><li>▪ Storing extra copies of programs and data files off-site</li><li>▪ Protection of Equipment against fire and other hazards</li><li>▪ Back-up power sources</li><li>▪ Disaster recovery procedures - Availability of back up facilities</li><li>▪ Maintenance agreements and insurance</li></ul>

(04 marks)

(Total 25 marks)

**End of Section C**

**Notice:**

These answers compiled and issued by the Education and Training Division of AAT Sri Lanka constitute part and parcel of study material for AAT students.

These should be understood as Suggested Answers to question set at AAT Examinations and should not be construed as the “Only” answers, or, for that matter even as “Model Answers”. 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.



---

© 2021 by the Association of Accounting Technicians of Sri Lanka (AAT Sri Lanka). All rights reserved. No part of this document may be reproduced or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without prior written permission of the Association of Accounting Technicians of Sri Lanka (AAT Sri Lanka)