



**ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA**  
**LEVEL III EXAMINATION - JULY 2023**  
**(303) FINANCIAL CONTROLS & AUDIT**  
**Model Paper**

- **Guidelines**

- (1) Paper consists of 3 sections.
- (2) Section A - All questions should be answered.
- (3) Section B - All questions should be answered.
- (4) Section C - Candidate can select 2 questions out of three questions.

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**Section A**

**Question 01**

- (i) What is meant by the term “**audit risk**”?
- (ii) State and briefly explain the three (03) components of audit risk.

**(5 marks)**

**Question 02**

Shamika is a member of AAT Sri Lanka and he is employed as an accountant in New Pharma (Pvt) Limited (“NPPL”), a pharmaceutical manufacturing company. He is in charge of the financial reporting and payment functions of NPPL.

**Required:**

- (i) **Explain** two (02) reasons why professional accountants should behave in an ethical manner when carrying out their professional work.
- (ii) **Identify** the need for ethical behavior from Shamika when dealing with money and payments of NPPL.

**(5 marks)**

**Question 03**

- (i) **State** two (02) reasons why external confirmations are considered as reliable audit evidence.
- (ii) **State** four (04) situations in which external confirmations can be used as audit evidence.

**(5 marks)**

#### Question 04

“The Code of Best Practice on Corporate Governance can be divided into two (02) main sections, in which it specifies certain duties for directors as well as for shareholders. Directors act as trustees/agents of the shareholders.”

- (i) **Explain** what the “Agency Conflict” is.
- (ii) **State** two (02) guidelines for Board of Directors that have been highlighted by the Code of Best Practice on Corporate Governance.

(5 marks)

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### **Section B**

#### Question 05

- (i) What are the basic elements of an Auditor’s Report?
- (ii) The auditor’s report issued to ABC Ltd. by XYZ & Co. Chartered Accountants is given below for your review.

(04 marks)

**Auditors Report**  
**To the Directors of ABC Ltd.**

**Report on the Financial Statements**

We have reviewed the accompanying financial statements of ABC Ltd. which comprise the balance sheet as at 31st March 2010, and the income statement, statement of changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory notes.

**Scope of Audit and Basis of opinion**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Sri Lanka Accounting Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit.

We therefore believe that our audit provides a reasonable basis for our opinion.

### Opinion

In our opinion so far as appears from our examination, the company maintained proper accounting records for the year ended 31st March 2010 and the financial statements give a correct view of the company's state of affairs as at 31st March 2010 and its profit and cash flows for the year ended in accordance with Sri Lanka Auditing Standards.

### **XYZ & Co.**

Chartered Accountants

**You are required** to, identify omissions / errors in the above audit report based on the recommended auditors report required by the Institute of Chartered Accountants of Sri Lanka.

**(6 marks)**

### **Question 06**

You are a member of the team auditing the financial statements of **Supri (Pvt) Ltd.** for the year ended 31st March 2012. You are responsible for auditing the Trade debtors. The audit manager has asked you to pay special attention on Trade debtors because the debtors' value shown in the financial statements amounting to Rs.1,332,000/- is significantly higher than the last year balance even though the sales value has remained constant.

Additionally, you have been given the following Trade debtors' age analysis:

<b>Trade Debtor</b>	<b>Balance as at 31<sup>st</sup> March 2012 Rs.</b>	<b>0 - 90 days Rs.</b>	<b>91 - 180 days Rs.</b>	<b>181 - 365 days Rs.</b>	<b>More than 365 days Rs.</b>
Gamini Stores	270,000	70,000	200,000	-	-
Kandurata (Pvt) Ltd.	220,000	-	-	-	220,000
Cash	215,000	-	215,000	-	-
Supun Super Market	412,000	200,000	150,000	-	-
Vasana Stores	80,000	80,000	-	-	-
<b>Total</b>	<b>1,197,000</b>	<b>350,000</b>	<b>565,000</b>	<b>-</b>	<b>220,000</b>

**You are required** to, identify four (04) audit issues apparent from the above data giving reasons why special attention should be given for those four areas in the audit.

**(10 marks)**

### **Question 07**

Many businesses today use IT systems to carry out processes and controls. While some entities develop their own IT systems, others purchase off-the-shelf IT systems in this regard. Controls procedures in an IT environment can be classified into general IT controls and application IT controls.

### **Required:**

**(a) Explain** the term "general IT controls" in a business organization.

**(2 marks)**

- (b) List three (03) examples of general IT controls. (3 marks)
- (c) Explain the term “application IT controls”. (2 marks)
- (d) List three (03) examples of application IT controls. (3 marks)
- (Total 10 marks)

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## Section C

### Question 08

- (a) Sri Lanka Framework for Assurance Engagements defines an Assurance Engagement. Identify four (04) key elements of an assurance engagement. (5 marks)
- (b) List the three (03) components of assurance engagement risk. (2 marks)
- (c) Describe how the evidence gathering process of a reasonable assurance engagement differs from the evidence gathering process of a limited assurance engagement. (5 marks)
- (d) You are the senior-in-charge of the audit of New Lanka Manufacturers PLC. The value of inventory of the entity at the end of the year is a significant part of its statement of financial position. You are in the process of carrying out substantive procedures on the valuation of inventories. Identify three (03) substantive procedures that an auditor could apply to verify the valuation of inventories (6 marks)
- (e) You are the senior-in-charge of the audit of Samanlal PLC, a company engaged in the construction industry. The following issues have arisen during the audit:  
Due to certain contracts not being finalised as of the year end, there was tremendous pressure on the sales staff to achieve revenue targets given for the year.
- The finance manager of the company left without a suitable replacement. The accountant with 10 years’ experience is overlooking the work of the finance manager.
  - Several entries have been passed to the revenue account manually (which is unusual as sales are based on system generated invoices) towards the year end.
- Explain three (03) circumstances that may indicate fraud and/or error that you would consider in the audit of Samanlal PLC. (7 marks)

### Question 09 (A)

Nuwan is a newly joined accounts executive of Speed Lanka (Pvt) Limited. Prabath is the senior associate for the audit of this company. Nuwan asked Prabath about the types of testing they will carry out for sales. Prabath explained the procedures involved in both test of controls and substantive procedures.

**Required:**

- (a) **Explain** the difference between test of controls and substantive procedures.

**(3 marks)**

Prabath and the audit team have identified the following controls relating to sales of the company and plan to test the controls:

- (i) Invoices are sequentially numbered
- (ii) All sales invoices are approved by the sales manager

**Required:**

- (a) **Identify** two (02) procedures the auditor may use in carrying out test of controls.

**(2 marks)**

- (b) **Explain** the audit evidence the auditor will gather in testing the two (02) controls mentioned in (i) and (ii) above.

**(3 marks)**

- (c) **Identify** two (02) substantive procedures the auditor may perform on sales.

**(2 marks)**

**(Total: 10 marks)**

**Question 9 (B)**

Domex Ltd is a privately owned company that operates a workshop which repairs electrical appliances such as refrigerators, washing machines and ovens. All repair jobs are supported by Job Cards and performed by qualified technicians.

Customers are required to pay either by cash or cheque upon collection of the repaired items. Cheques are accepted only from corporate customers. The following procedures are applied to the collection and banking cycle.

- The cashier collects cash or cheques from customers when collecting the repaired items. A system generated receipt is issued to the customer at the same time.
- The cashier posts the receipts to the cash book at the end of the day and also updates the sales ledger.
- Corporate customers post their cheques under registered cover and the receptionist opens the mail and she records the cheque details in the inward cheque register. Cheques are then handed over to the cashier.
- When the cashier is on leave, cash and cheques are collected by any member of the finance team available and system receipts are issued to customers. The cashier has written his password in a notepad for use of the finance team members only when he is on leave.
- An accounts assistant prepares bank reconciliations on a monthly basis and submits them for the review of the accountant if requested.

**Required:**

- (i) State three (03) objectives of the internal controls that should be exercised over the cash and banking cycle.  
(3 marks)
- (ii) Identify five (05) deficiencies in the above-mentioned procedures of Domex Ltd and explain their potential consequences.  
(10 marks)
- (iii) State one (01) control to address each of these deficiencies identified in (2) above.  
(2 marks)

**Question 11**

- (a) List four (4) factors that the auditor should consider in forming the audit conclusions.  
(5 marks)
- (b) State three (3) important matters included in the introductory paragraph of an auditor's report.  
(5 marks)
- (c) You are the senior in charge of the audit of Matara Foods PLC for the year ended 31 March 2012. The Statement of Financial Position of the company reflects inventory balances that are held by third parties. This is a significant balance, but the company has not carried out a physical count for these balances. You have requested to call for confirmation of these balances but the management is not agreeing with such audit procedure as they believe that it is a wasted effort. The management has requested that the audit should be finalized as soon as possible since it will take a long time to collect/receive balance confirmations from third parties.
  - (i) Assess the impact of the above issue on the audit opinion.  
(5 marks)
  - (ii) Propose two (2) possible modifications to the audit opinion that may arise from the above issue.  
(5 marks)
- (d) How an auditor highlights a matter affecting financial statements without qualifying an opinion? State two (2) instances that an auditor may give such an opinion.  
(5 marks)

