

## Advanced Audit and Assurance Model Paper

### Section A

#### 01. Question 01

- (i) What is meant by the term "audit risk"? (2 marks)  
(ii) State and briefly explain the three (03) components of audit risk. (3 marks)

#### 02. Question 02

You are the senior in charge of the team auditing the financial statements of XYZ (Pvt) Ltd. for the year ended 31st March 2013. Your manager informs you that there is an increased risk of fraudulent financial reporting in XYZ (Pvt) Ltd. as the sales value reported for the year in the financial statements is just above the target given to Sales Managers. By achieving this target, the Sales Managers of XYZ (Pvt) Ltd. are to receive an increased bonus.

- I. Identify two (02) techniques in which management can fraudulently report a higher sales value than the actual sales value. (2 marks)  
II. State two (02) audit procedures that you would perform to address this risk. (3 marks)

#### 03. Question 03

- I. State two (02) reasons why external confirmations are considered as reliable audit evidence. (2 marks)  
II. State three (03) situations in which external confirmations can be used as audit evidence. (3 marks)

#### 04. Question 04

A partner of XYZ audit firm informs one of his audit clients that there are inherent limitations of an audit and as a result there is an unavoidable risk that some material misstatements of financial statements may not be detected from an audit

Identify two (02) inherent limitations of an audit in detecting all material misstatements in financial statements arising from fraud and error. (2marks)

Briefly explain the following fundamental principles stated in the Code of Professional Conduct and Ethics applicable for the members of AAT Sri Lanka: (3 marks)

- a) Objectivity  
b) Confidentiality

**SECTION B**

**Question 05**

A) 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:

Trade Debtor	Balance as at 31 <sup>st</sup> March 2012 Rs.	0 - 90 days Rs.	91 - 180 days Rs.	181 - 365 days Rs.	More than 365 days Rs.
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. **(4 marks)**

B) When understanding an entity and its environment, the entity's internal control is one of the general areas considered by the auditor.

You are required to:

Define the Definition of Internal Control Systems **(3 marks)**

State three (03) components of the entity's internal control system. **(3 marks)**

**Question 06**

A) ABC PLC is a quoted public company operated in the Export Industry and the Company exports its products to the different customers who located in Europe. As per the latest available Bill of Lading (BOL), the Company handed over the goods to the shipping Company after the current financial year and the Company recognized the revenue based on the Export Invoice, which has been raised during the financial year. As per the signed Import and Export Agreement, the risk and rewards of the goods will be transferred to the customer upon ABC handing over the goods to the shipping company to exports. However, when you highlighted this point to the Finance Manager of ABC PLC, he has handed over a letter to you, signed by the Clearing Agent of ABC Company, stating that the goods were handed over to the shipping company during the financial year.

You are the auditor of ABC PLC and critically evaluate the above scenario **(5 marks)**

- B) Sufficient and Appropriateness are interrelated, and it is applicable to Audit Evidences obtained through, Risk Assessment Procedures, Test of Controls and Substantive Procedures. Sufficient is applicable to quantity of the audit evidence obtained and Appropriateness is applicable to Relevance, Quality and Reliability of the Audit Evidence obtained.

When conducting the Audits, the Auditor should obtain Sufficient and Appropriate Audit Evidences from various sources covering each and every applicable assertion. In practical, Auditor may obtain different Audit Evidences, from various sources to cover the same assertion.

Some sources are within the direct control of the Auditor and some are don't. Therefore, when considering the Reliability and the Quality of the audit evidences, auditor has to look different aspects based on the sources of the audit evidence obtained.

While considering the Reliability and the Quality of the Audit Evidences obtained from various sources and while giving the examples, you are required to critically evaluate the above mentioned scenario. **(5 marks)**

### Question 07

- A) Managing Director of AB (Pvt) Ltd. has requested Sudath, a partner of R & R Associates, a firm of Chartered Accountants to immediately accept the statutory audit engagement of AB (Pvt) Ltd. for the year ended 31st March 2023. R & R Associates has never worked before with AB (Pvt) Ltd.

You are required to:

Discuss whether Sudath can accept this audit immediately. **(4 marks)**

- B) UB (Pvt) Ltd. is an audit client of Eric Associates since 2000. From the financial year 2022/23, Nimal became the audit partner for this engagement. The chairman of UB (Pvt) Ltd. has offered 5 days of stay in a Villa at Maldives as the New Year gift to Nimal. The chairman has asked the audit manager of Eric Associates to join as the finance manager during the audit and the audit manager is negotiating the terms of employment with the Chairman. The audit team has identified that the company has capitalized Rs. 30 million as borrowing cost even after completing the construction of its new warehouse. The materiality determined for the audit is Rs. 15 million. The chairman informed the audit partner that he would impose a fee cut if he is not agreeing to the capitalization of the borrowing cost.

You are required to:

Explain three(03) threats to compliance with fundamental principles of ethics with reference to the above scenario. **(6 Marks)**

## **SECTION C**

### **Question 08**

A) Corporate governance guidance in Sri Lanka is provided in the Code of Best Practice on Corporate Governance 2013 issued jointly by the Securities and Exchange Commission of Sri Lanka and the Institute of Chartered Accountants of Sri Lanka.

You are required to:

(a) Explain the importance of Corporate Governance. **(04 marks)**

(b) State three (03) guidelines that have been highlighted by the Code of Best Practice on Corporate Governance. **(03 Marks)**

B) Mrs. Madapatha who is a Master of Designing fashion items received an award in 2016 for designing of fashion items. Since she is getting many orders for designing of fashion items after the award was received, she started a small garment manufacturing entity with a Rs.30 million bank loan facility. She does not have any accounting background but the bank manager insisted her several times to recruit an accountant to manage her finance activities. Assume that she has recruited you as the accountant of her business. This is your first week in the office and you have gathered the information below:

- Factory building construction is almost over now. Mrs. Madapatha has already completed and supplied six orders to retail outlets.
- Forty five (45) employees are working in this factory.
- Mrs. Madapatha purchased fabrics from the local market by her own on several occasions but now the supervisor is attending for purchasing activities.
- Purchases are made on one month credit basis.
- Last week, one purchase order was returned back to the supplier since it was not up to the required quality specifications.
- Further, at most of the instances suppliers submit invoices for incorrect amounts or for goods that have not been delivered.
- Supervisor has purchased some items at higher price than Mrs. Madapatha purchased before.
- Due to the unique designs, the demand has increased and a rapid growth of the business is expected.

During the last discussion, she requested you to overlook the purchasing process and report her your concerns. At the discussion you have stated the importance of having a good internal control system in the entity. Mrs. Madapatha wants to know whether by implementing a good internal control system she can have 100% assurance that there will be no errors, mistakes and frauds within the organization.

You are required to:

- (a) Explain the purchasing process (procurement process) which would be appropriate for Mrs. Madapatha's organization (your answer should be supported with minimum of 4 steps of an ideal purchasing process). **(8 marks)**
- (b) Explain three(03) risks that will be mitigated by implementing a good purchasing process. **(6 marks)**
- (c) Discuss whether Mrs. Madapatha can have 100% error free situation by having a good internal control system in the organization. **(4 marks)**

**Question 09**

- (A) List three (3) factors that the auditor should consider in forming the audit conclusions. **(3 marks)**
- (B) State three (2) important matters included in the Opinion 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 2023. 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.

Assess the impact of the above issue on the audit opinion. **(7 marks)**

- D) You are the audit manager of the audit of the financial statements of IT Solutions (Pvt) Ltd. for the year ended 31st March 2023. The company imports and sells IT related equipments.

Your review of the working papers revealed the following:

- Closing inventories as per the valuation report - Rs.12,677,850/-.
- In February and March, some items have been sold at a price less than the cost which is stated in the stock valuation report.
- The inventory value should be less by Rs.4,655,000/- if those are to be valued at lower of the cost and net realizable value.
- However the management has not agreed to adjust the value of the inventory in the financial statements

Assess the impact of the above issues to the audit opinion on the company's financial statements for the year ended 31st March 2023 **(5 Marks)**

- E) How an auditor highlights a matter affecting financial statements without qualifying an opinion? **(3 Marks)**

State two (2) instances that an auditor may give such an opinion. **(2 Marks)**