

## ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

### LEVEL III EXAMINATION - JANUARY 2026

#### (303) FINANCIAL CONTROLS & AUDIT

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

(1) **Time Allowed:** *Reading : 15 minutes.*

07-02-2026

Afternoon

[01.45 - 05.00]

*Writing : 03 hours.*

No. of Pages : 07

No. of Questions : 09

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

(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.**

#### **SECTION A**

(Total 20 marks)

#### **Question 01**

The business organizations can be differentiated based on different criteria such as ownership, control structure and objectives, etc. **Sunil** intends to start a business with his wife, and they want to ensure whether their personal liability is limited only to the amount they invest in the business and whether their personal assets remain protected from business's debts.

**You are required to:**

(a) **List** three(03) main types of Business Organizations operated in Sri Lanka. (03 marks)

(b) **Identify** the most suitable type of business organization that **Sunil** and his wife can start based on their requirements. (02 marks)

(Total 05 marks)

#### **Question 02**

**Dimantha** worked as an assistant engineer in a well reputed solar power supplying company and he possesses extensive knowledge on solar power sector. **Manjula** is **Dimantha's** brother who owns a restaurant chain and he has agreed to invest in a new solar power project.

**You are required to:**

**State** three(03) internal risks and two(02) external risks associated with investing in a new solar power project. (05 marks)

## Question 03

**Perera** has applied for a bank loan to start a retail business. The bank has requested to submit a profits forecast for next 5 years of **Perera's** new business and this forecast must be certified by a Qualified Chartered Accountant. To fulfill this requirement, **Perera** approached **GSB Associates**, a firm of Chartered Accountants and inquired whether the firm could provide an assurance on the forecasted profits for the next 5 years.

**You are required to:**

(a) **State** three(03) differences between a "Reasonable Assurance Engagement" and a "Limited Assurance Engagement". (03 marks)

(b) **Explain** the most appropriate assurance type that **GSB Associates** may provide on the forecasted profits of **Perera's** new business. (02 marks)

(Total 05 marks)

## Question 04

Managing Partner of **T & J Associates** wants to implement policies and procedures on quality control requirements in performing audits on financial statements. He emphasized that the engagement partner is ultimately responsible for the quality control of individual engagements.

**You are required to:**

(a) **State** the objective of a system of quality control. (03 marks)

(b) **State** two(02) policies and procedures that need to be considered for quality control of individual engagements. (02 marks)

(Total 05 marks)

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*End of Section A*

## **SECTION B**

(Total 30 marks)

## Question 05

**Rikzo PLC** is engaged in the business of trading pharmaceutical items in the local market as well as in the international market. **Rikzo PLC** is the second largest company in the local market according to the recently published statistical reports by the Pharmaceutical Association. The company has a robust budgetary process and Head of Sales monitors the performance against the budget to ensure sales targets are achieved.

Sales for some months have varied due to the sales made to State Pharmaceutical Corporation (SPC) and to the Army Forces. During the procurement period of such government institutions, the company showed increased sales due to the bulk nature of their orders.

**Rikzo PLC** has shown good results over the past 3 years and this year, and it has demonstrated increased performance due to the introduction of two new vaccines for cancer patients.

The export sales to Maldives and Bhutan are based on the CIF terms. **Rikzo PLC** sells pharmaceutical items to its subsidiary company which in turn exports to African countries. Such sales made to the subsidiary company form a significant portion of **Rikzo PLC's** total revenue.

The auditor of **Rikzo PLC** has identified that “revenue recognition” as a significant risk. You have been assigned as the Audit Senior to carry out the audit of **Rikzo PLC** for the year ended 31<sup>st</sup> December 2025.

**You are required to:**

(a) **Identify** three(03) matters that the auditor shall need to understand when performing the audit of the financial statements of **Rikzo PLC**. (03 marks)

(b) **State** four(04) audit procedures that need to be performed in auditing revenue (sales) of **Rikzo PLC**. (04 marks)

(c) **Explain** what is meant by sufficiency and appropriateness of audit evidences. (03 marks)

(Total 10 marks)

## Question 06

**Nova PLC** is engaged in manufacturing and selling stationery items. During the year, the newly implemented Enterprise Resource Planning (ERP) system encountered several issues.

At a special audit committee meeting held during the planning stage, the engagement partner highlighted the following issues with reference to the audit of financial statements for the year ended 31<sup>st</sup> March 2025:

- Debtors represent 23% of the company's total assets. The company estimated debtors' impairment as Rs. 6 million. However, due to the system issue, the age analysis of trade debtors cannot be generated and hence the debtors' impairment cannot be reliably computed by the auditor.
- Inventory of the company is fast moving, and purchasing and manufacturing are mainly done based on confirmed orders. However, the inventory aging report indicates that a significant provision is required for finished product. The estimated provision is 2.5 times of the materiality as determined by the auditor. However, the management informed that no provision is required for the inventory since there are no slow-moving items.

The materiality applicable for the audit was Rs. 5 million.

**You are required to:**

(a) **Assess** the impact of the following two matters on the audit opinion in the auditor's report of **Nova PLC**:

- (i) Impairment of debtors.
- (ii) Provision for slow moving inventory items. (07 marks)

(b) **Explain** what is meant by “Unmodified Audit Opinion”. (03 marks)

(Total 10 marks)

## Question 07

**Ramith** is an audit manager at **Zing Associates**, a firm of Chartered Accountants and he was assigned to carry out the audit of **Marvel PLC** Group, which has 32 subsidiaries. **Ramith** is qualified as a professional accountant and he left the audit firm during the audit of **Marvel PLC** to join a private limited company. **Ramith** has a sound understanding about **Marvel PLC**'s operations and he trades shares of **Marvel PLC** in the stock exchange.

**Marvel PLC** has been audited by **Zing Associates** for the last 25 years and the Managing Partner of **Zing Associates** met the Managing Director of **Marvel PLC** during the last week. **Marvel PLC** is a key client of **Zing Associates**, representing 23% of **Zing Associates**' total revenue.

Managing Director of **Marvel PLC** requested **Zing Associates** to accept the internal audit of the IT Company which is a subsidiary of the **Marvel PLC** Group. Further, Managing Director wanted feedback about **Ramith** who has applied for the finance manager position of that company. The Managing Partner of **Zing Associates** gave a positive feedback about **Ramith**, recommended him and agreed to replace a new manager for the ongoing audit of **Marvel PLC** Group. Also, **Zing Associates** accepted the internal audit assignment of the IT subsidiary company and agreed to provide the recommendations on the financial processes.

**You are required to:**

- (a) **Explain** two(02) circumstances / relationships that can be recognized as possible threats to Auditor's independence in the above scenario. (03 marks)
- (b) **Assess** two(02) threats to **Zing Associates** to comply with the fundamental principles of ethics with reference to the above facts. (04 marks)
- (c) **Identify** three(03) safeguards to eliminate or reduce the above (b) identified threats to an acceptable level. (03 marks)  
(Total 10 marks)

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*End of Section B*

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## **SECTION C**

(Total 50 marks)

## Question 08

**Duro (Pvt) Ltd.** is engaged in manufacturing consumer goods. The company generates profits and its turnover was Rs. 1.12 billion in last financial year (2024). Most of the raw materials that are used for the production processes are imported. Due to the high cost associated with placing orders, the company typically imports materials in quantities sufficient to cover several months of operations.

There are six Production Supervisors for each production line who report directly to the Production Manager. These supervisors are responsible for preparing Material Requisition Notes, specifying the items required for production. Upon approval by the Production Manager, the Requisition Notes are forwarded to the Stores Manager. The Stores Clerk then dispatches the requested materials from the store and prepares an Item Issued Note, which is then signed and authorized by the Stores Manager. In cases where materials are returned from the production floor, a Return Note is prepared. These returns are documented and acknowledged with signatures from both the Production Supervisor and the Production Manager.

Physical verification of all raw materials and finished goods is carried out by the Internal Auditors. Apart from very minor variances, the book balances are found to be in agreement with the physical inventory. As part of their internal audit procedures, the Internal Auditors regularly review the records maintained by the Stores Manager, including all purchase requisitions and item issued notes. The Managing Director, **Dissanayaka**, has expressed his commitment to maintaining an error-free and fraud free system through effective internal controls during the post-audit discussion with the internal audit team.

The Company uses an Enterprise Resource Planning (ERP) System purchased from a well reputed vendor, which integrates all key business process modules. The IT Department facilitates the operation of business processes and addresses ERP-related issues or modification requests. Additionally, system's support and maintenance are provided by the ERP vendor in accordance with the terms of the maintenance agreement. Further, **Dissanayaka** noted that, while the inventory control process is at an acceptable level, there are deficiencies in the internal controls relating to the procurement process.

**You are required to:**

- (a) **State** two(02) preventive controls and two(02) detective controls that can be used by **Duro (Pvt) Ltd.** (04 marks)
- (b) **Explain** three(03) control activities within the inventory management process of **Duro (Pvt) Ltd.** with the purpose of each control activities identified. (06 marks)
- (c) **Explain** two(02) objectives of an internal control system of **Duro (Pvt) Ltd.** (05 marks)
- (d) **Identify** four(04) business risks associated with the procurement process. (04 marks)
- (e) **State** three(03) general IT controls that can be implemented by **Duro (Pvt) Ltd.** with an example for each. (06 marks)

(Total 25 marks)

## Question 09

**Osada** is the audit senior of the audit of **Reko PLC** which is an initial audit for **D & Y Associates**. **Osada** noted that **Reko PLC** has incurred losses during the last two financial years. In summary, it was noted that the management fees of the parent company introduced during the year and other changes introduced by the parent company have caused these losses. The current Enterprise Resource Planning (ERP) system does not facilitate to track the related party transactions. Related party transactions are not supported by agreements. The parent company of **Reko PLC** was registered under the Board of Investment and is exempted from income tax for a period of 20 years from the date of commencement of commercial operations. During the year, the **Reko PLC** acquired another company and there is a requirement to prepare consolidated financial statements.

The company recorded a revenue of Rs. 18.35 million during the year. The shareholders are mainly concerned about the revenue growth and revenue is the key performance area. The incentives of the key management have been linked to the revenue growth. The management has changed the accounting policy during the year, and the revenue is recognized for all the confirmed orders before the goods are dispatched to the customers. Such adjustments as at the year-end were Rs. 84.5 million. Trade receivable balance has not been properly updated during the year by setting off the advances received from the customers.

The auditor of the company noted during the stock counts that certain inventory items were recorded as sold but, had not yet been delivered to customers, and no customers' acknowledgments were available. These inventory items were mixed with the unsold inventory, making it difficult for management to reconcile the inventory differences.

**You are required to:**

- (a) **Identify** five(05) items / matters that require specific attention in performing the audit process at **Reko PLC**. (05 marks)
- (b) **State** four(04) factors that may affect the identification of materiality based on an appropriate benchmark of **Reko PLC**. (04 marks)
- (c) (i) **State** two(02) factors that indicate a risk may be significant. (02 marks)  
(ii) **Explain** the main fraud risk to be considered when performing the audit of **Reko PLC**, based on the information provided in the scenario. (04 marks)
- (d) **State** five(05) matters to be inquired from the management of **Reko PLC** in identifying the risk of misstatements due to fraud. (05 marks)
- (e) **State** five(05) audit procedures that need to be performed regarding related party transactions of **Reko PLC**. (05 marks)

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(Total 25 marks)

## **ACTION VERBS CHECK LIST**

<b>Level of Competency</b>	<b>Description</b>	<b>Action Verbs</b>	<b>Verb Definitions</b>
<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.

<b>Level of Competency</b>	<b>Description</b>	<b>Action Verbs</b>	<b>Verb Definitions</b>
<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.

<b>Level of Competency</b>	<b>Description</b>	<b>Action Verbs</b>	<b>Verb Definitions</b>
<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.

<b>Level of Competency</b>	<b>Description</b>	<b>Action Verbs</b>	<b>Verb Definitions</b>
<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.