ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

LEVEL 03 EXAMINATION - JULY 2026

(3803) RISK, CONTROLS & AUDIT

25-07-2026
Afternoon
[01.45 – 05.00]

No. of Pages : 07
No. of Questions : 09

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

(1) ***Time Allowed:*** *Reading : 15 minutes.*
Writing : 03 hours.

(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

Namal recently invested in the stock market. He received a notice to attend the Annual General Meeting (AGM) of a listed company. However, he does not have a clear understanding how listed companies operate.

You are required to:

Explain the "Agency Theory" and "Stewardship Theory" to **Namal.** (05 marks)

Question 02

The Chief Executive Officer (CEO) of **Best PLC** has formally approached **ABC Chartered Accountants** seeking assurance services. In response, the CEO requires a written proposal that outlines the full range of assurance engagement services that **ABC Chartered Accountants** can provide to **Best PLC.**

The proposal should specifically explain the scope and relevance of the following types of assurance services:

(i) Financial Statements Audit (Statutory Audit).

(ii) Compliance Audit.

You are required to:

Explain the objective of each of the assurance services stated in (i) and (ii) above to be included as part of the proposal to be sent to **Best PLC.** (05 marks)

Question 03

Fashions (Pvt) Ltd. *('the Company")* recently launched its first ever online cash on delivery sales services. The Company needs to analyze its business processes to understand the potential areas for improvement, commencing from the order placed by the customer to the delivery point. The company intends to introduce all possible digital tools to improve the business.

You are required to:

(a) **State** two(02) ways in which recognizing the interdependence of business processes assists an auditor. (02 marks)

(b) **State** three(03) advantages of using digital tools in business processes. (03 marks)

(Total 05 marks)

Question 04

Marks PLC, a leading manufacturing organization, is currently facing significant challenges. The company has been losing market share due to low cost imports. Recently, the company has discovered a major fraud involving its Head of Sales, and has failed to meet statutory financial reporting deadlines. These issues have raised serious concerns over governance and compliance.

You are required to:

(a) **Explain** two(02) main types of internal risks that **Marks PLC** could face based on the above facts. (03 marks)

(b) **Identify** two(02) data analytics techniques used for the effective risk management. (02 marks)

(Total 05 marks)

End of Section A

SECTION B

(Total 30 marks)

Question 05

Saman completed his AAT examinations a few years ago before migrating to Australia to pursue his higher academic education. He now works as a Finance Controller in a construction company.

His father, who is an engineer, is the Managing Director of **Nimna Holdings (Pvt) Ltd.,** a construction company. **Nimna Holdings (Pvt) Ltd.** has recently diversified into industrial solar projects. The company is now performing well in both sectors.

During **Saman's** last vacation, he visited the head office of **Nimna Holdings (Pvt) Ltd.** and engaged with the finance team. **Saman** advised his father to strengthen key governance practices, particularly in financial reporting, including the financial statement closure process and governance on related party transactions. He also observed a heavy reliance on manual work.

You are required to:

(a) **Explain** the role of governance process on related-party transactions as a governance aspect in ensuring compliance, transparency, and accountability. (04 marks)

(b) **State** three(03) ways how automation can be done in business processes of **Nimna Holdings (Pvt) Ltd.** (03 marks)

(c) **State** three(03) challenges of using digital tools in business processes. (03 marks)

(Total 10 marks)

Question 06

High Path Constructions Ltd. is an established construction company with over three decades of operations. Recently, the government announced that all future road development projects will be handled exclusively by the Road Development Authority and no tenders are offered to private companies.

In response, the Chairman of **High Path Constructions Ltd.** convened an urgent board meeting and emphasized the need to adopt risk reduction strategies. The CFO presented financial information, highlighting that 87% of the company's revenue depends on government projects, exposing the company to a significant risk.

The Chairman appointed a sub-committee to explore possible risk mitigation techniques and instructed the Risk Compliance Officer of the company to prepare a strategy for risk identification using digital tools.

You are required to:

(a) **Explain** two(02) risk mitigation techniques that **High Path Constructions Ltd.** can implement. (04 marks)

(b) **State** three(03) digital transformation related risks of **High Path Constructions Ltd.** (03 marks)

(c) **Explain** what is meant by risk assessment of the Risk Management Framework used by **High Path Constructions Ltd.** (03 marks)

(Total 10 marks)

Question 07

Bio Products (Pvt) Ltd. is engaged in the manufacturing of coconut oil and coconut milk products, primarily for export to Australia and a few other countries. Last month, **Bio Products (Pvt) Ltd.'s** main customer visited the company and informed the Managing Director (MD) that Australian consumers prefer fair trade-certified products. He therefore urged **Bio Products (Pvt) Ltd.** to adopt more sustainable practices and ensure that its operations align with ethical standards that promote trust, fairness, and responsibility.

In response, the MD decided to integrate sustainability into **Bio Products (Pvt) Ltd.'s** purchasing policy. The management also resolved to implement internal controls with the aim of obtaining certifications and awards for sustainable practices.

You are required to:

(a) **Identify** two(02) sustainable practices which can be implemented in the **Bio Products (Pvt) Ltd.'s** purchasing policy. (02 marks)

(b) **State** four(04) risks involved in inventory management of **Bio Products (Pvt) Ltd.** (04 marks)

(c) **State** four(04) inherent limitations of internal controls. (04 marks)

(Total 10 marks)

End of Section B

SECTION C

(Total 50 marks)

Question 08

Medi Lab (Pvt) Ltd. commenced its' operations in 2023, offering a range of patient-focused services including cancer detection tests, comprehensive diagnostic services, and channelling facilities.

Financial Extracts for the year ended 31st December 2025 are as follows:

(Rs. '000)

Revenue:		
Laboratory Services	315,122	
Channelling Income	95,163	
Pharmacy Sales	60,327	
Total Revenue		**470,612**
Cost of sales		(259,719)
Administration Expenses:		
Office Expenses	(15,230)	
Salaries	(11,260)	
Directors' Salaries	(24,000)	(50,490)
Finance Expenses:		
Bank Loan Interest	(162,160)	(162,160)
Net Loss for the Year		**(1,757)**

Governance and Management:

Medi Lab (Pvt) Ltd. is led by three directors:

- **Kamal** – A General Physician engaged in private practice while contributing to **Medi Lab (Pvt) Ltd.'s** medical services.
- **Sunil –** Oversees laboratory operations.
- **Ranil –** A Chartered Accountant, responsible for finance and administration.

The statutory audit of **Medi Lab (Pvt) Ltd.** is conducted by **SA Associates** under the leadership of Partner **Samanthi**, who previously completed her articles at **Ranil's** audit firm. **SA Associates** is also aware that **Medi Lab (Pvt) Ltd.** is considering renewing the audit engagement for an extended period and the management has hinted that continued cooperation and flexibility from the auditor would be appreciated. **Medi Lab (Pvt) Ltd.** also has an independent internal audit team reporting directly to the Board of Directors.

Strategic Consideration:

The directors are considering importing advanced laboratory equipment costing over Rs. 700 million financed through a bank loan. The bank is ready to provide a loan facility for these laboratory equipment. With this investment, a full range of diagnostic reports will be available in Sri Lanka, which can significantly reduce the need to travel oversees for medical tests.

However, critical market intelligence is lacking and neither survey data nor cost–benefit analysis has been conducted to estimate patient demand, such as monthly volumes of specialized tests or to assess whether the additional cash inflows would be sufficient to settle the bank loan instalments.

You are required to:

(a) (i) **Define** what is meant by "Risk Appetite" in the Enterprise Risk Management (ERM). (03 marks)

(ii) **State** four(04) elements of ERM in COSO. (04 marks)

(b) **State** four(04) benefits that **Medi Lab (Pvt) Ltd.** can enjoy by choosing a right risk mitigating strategy. (04 marks)

(c) **Explain** two(02) ways how **Medi Lab (Pvt) Ltd.'s** internal auditors can use data analytics and AI to verify the revenue of laboratory services income and pharmacy operations. (04 marks)

(d) **State** three(03) roles / functions of internal auditing of **Medi Lab (Pvt) Ltd.** (03 marks)

(e) **Assess** two(02) threats to **SA Associates** to comply with the fundamental principles of ethics in auditing **Medi Lab (Pvt) Ltd.** (04 marks)

(f) **State** three(03) safeguards to eliminate or reduce the above (e) identified threats to acceptable level. (03 marks)

(Total 25 marks)

Question 09

ABC Associates, a firm of Chartered Accountants has been appointed as the new auditors of **Magical Ltd.**, a medium-sized company operating in the consumer goods sector for the audit of financial statement for the year ended 31st March 2026. The company has been incurring recurring operating losses but is aggressively pursuing revenue growth through expansion into new markets. The management is mainly focused on increasing revenue, even if this results in weaker internal controls and less compliance with rules and regulations.

During the audit for the year ended 31st March 2026, the following issues were identified:

(1) Inventory Cut off and Valuation: Goods worth Rs. 3 million were dispatched to the customers before month-end of March 2026, but recorded in the ledger after March month end (in April 2026). This cut off error understated cost of sales.

(2) Trade Receivables and Impairment: **Magical Ltd.** lacks a proper impairment model. The recalculated impairment resulted in an under-provision of Rs. 1.8 million for trade receivables.

(3) Revenue (Sales) Recognition Practices: Sales staff are entitled to receive incentives based on the achievement of revenue targets, creating pressure to record revenue prematurely. Auditors noted instances of bill-and-hold arrangements and sending extra products to distributors to boost sales figures, both of which raise fraud risk indicators.

The management of **Magical Ltd.** did not agree to adjust the above in the financial statements for the year ended 31st March 2026. The audit team has determined overall materiality at Rs. 2.5 million. Further, revenue recognition has been considered as a fraud risk factor.

You are required to:

(a) **Identify** four(04) matters that require a special attention in performing the audit process of **Magical Ltd.** (04 marks)

(b) **Explain** why revenue recognition of **Magical Ltd.** is considered as a significant risk factor. (03 marks)

(c) **State** three(03) factors that may affect establishment of materiality based on an appropriate bench mark for **Magical Ltd.** (03 marks)

(d) **Explain** the responsibility of the management of **Magical Ltd.** regarding prevention and detection of frauds. (04 marks)

(e) **State** five(05) audit procedures that need to be performed regarding revenue of **Magical Ltd.** (05 marks)

(f) **Assess** the impact of the above matters stated in 1 – 2 on the audit opinion of auditor's report on the financial statements of **Magical Ltd.** for the year ended 31st March 2026. (06 marks)

(Total 25 marks)

End of Section C

Action Verbs Check List

Level	Action Verb	Definition	Detailed Instructions for Students
REMEMBER Recalling facts, terms, basic concepts, or answers without necessarily understanding what they mean.	**Identify**	Recognition of someone or something.	Find and name key parts of the topic.
	Define	Meaning of a word or concept.	Provide a clear meaning of a term or concept.
	Recognise	Awareness of something seen before.	Spot and acknowledge something from previous learning.
	State	Clear and concise expression of information.	Express key facts or concepts in a straightforward way.
	List	A series of names, numbers, or items.	Write down key points in an organized manner.
	Record	Entry of details into a system (not accounting).	Enter relevant details clearly and accurately.
UNDERSTAND Comprehending the meaning of informational materials and being able to interpret or explain it.	**Construct**	Formation of something by combining elements.	Bring together different parts into a meaningful whole.
	Differentiate	Recognition of differences between two or more things.	Highlight distinctions between concepts or items.
	Discuss	Consideration of different ideas and opinions about a topic.	Explore various perspectives and provide insights.
	Explain	Clarification of something in greater detail.	Provide a logical and detailed description.
	Illustrate	Use of examples, charts, or visuals to clarify a point.	Support explanations with appropriate examples or visuals.
	Interpret	Explanation of the meaning of information or actions.	Explain what something means in your own words.
	Describe	A detailed account of something.	Provide relevant details in a structured manner.
	Summarise	A brief statement of the main points.	Present key information concisely.
APPLY Using learned material in new and concrete situations. It requires the practical application of knowledge and skills.	**Apply**	Use of knowledge, skills, or rules in a situation.	Utilise relevant knowledge or techniques to achieve an outcome.
	Calculate	Determination of a value through mathematical or logical methods.	Use numerical or logical processes to reach a solution.
	Determine	Establishment of something through research or calculation.	Find out or conclude something after calculation or research.
	Demonstrate	Display of a process or method.	Show a clear example through structured steps.
	Prepare	Organisation of materials or information for use.	Arrange necessary details before engaging in a task.
	Use	Application of a concept, tool, or method for a purpose.	Implement relevant knowledge or resources appropriately.
	Present	Sharing of information effectively.	Deliver key insights clearly and professionally.
ANALYSE 1Breaking down information into its components to understand its structure and relationships.	**Analyse**	Detailed examination of something to understand its components.	Break down information into key parts for better understanding.
	Compare	Examination of similarities and/or differences.	Point out the key commonalities and distinctions.
	Distinguish	Recognition of unique characteristics.	Identify what makes things different from each other.
	Examine	Inspection of something to determine its nature.	Look at something closely to understand it better.
	Outline	Summary of the main points.	Provide an organised overview of key aspects.
	Conduct	Organisation of elements for an experiment, survey, or study.	Follow structured steps to carry out a task systematically.
	Report	Structured presentation of findings.	Present analysed information in a clear and logical format.
EVALUATE Making judgments about the value or quality of ideas or materials based on criteria or standards.	**Advise**	Offering of suggestions or recommendations.	Provide informed guidance based on analysis.
	Evaluate	Critical assessment of value, effectiveness, or impact.	Judge the quality or relevance of something based on criteria.
	Formulate	Development of a structured approach or plan.	Create a well-defined method or strategy.
	Recommend	Suggestion of a suitable course of action.	Propose an approach backed by logical reasoning.
CREATE Combining elements in novel ways to form a coherent or functional whole; the ability to generate new ideas, products, or ways of understanding.	**Create**	Generation of something new.	Develop something original and purposeful.
	Assess	Estimation or evaluation of quality, ability, or nature.	Provide a reasoned judgment based on available information.
	Develop	Expansion or refinement of an idea, product, or concept.	Strengthen and improve an idea over time.
	Propose	Suggestion of a plan or concept for consideration.	Present an idea or structured recommendation.
	Synthesis	Combination of different elements to form a coherent whole.	Integrate multiple ideas or insights into a meaningful conclusion.
	Design	Creation of a structured plan for something	Formulate a detailed structure for a product or process.
	Compile	Assembly of information from various sources.	Organise collected data into a comprehensive format.