



**ASSOCIATION OF ACCOUNTING TECHNICIANS
OF SRI LANKA**

CURRICULUM 2025

PILOT PAPER

Level 03

3803 - RISK, CONTROLS & AUDIT (RCA)

A publication of the Education and Training Division

Association of Accounting Technicians of Sri Lanka

3803 – Risk, Controls & Audit (RCA)

Instructions to Candidates (Please Read Carefully)

Time Allowed:

Reading	:	15 Minutes
Writing	:	03 Hours

Structure of Question Paper:

- This paper consists of three Sections; Section A, Section B and Section C.
- All the questions of Section A, Section B and Section C should be answered.

Marks:

- Allocation of marks for each section:

Section	Marks
Section A	20
Section B	30
Section C	50
Total	100

- Marks for each question are shown with the question.
- The pass mark for this paper is 50.

Answers:

- All answers should be written in the booklet provided, answers written on the question paper will not be considered for marking.
- Begin your answer of each question on a new page.
- All workings should be clearly shown.
- Do not write on the Margins.

Answer Booklets:

- Instructions are shown on the front cover of each answer booklet.

Calculators:

- Candidates may use any calculator except those with the facility for symbolic algebra and differentiation. No programmable calculators are allowed.

Attached:

- Action verb checklist – Each question will begin with an action verb (excluding OTQ's).
- Students should answer the questions based on the definition of the verb given in the checklist.

Four (04) Compulsory questions

(Total – 20 marks)

SECTION A**Question 01**

Millennium Tech Ltd. is a fast-growing technology firm and it is in the process of strengthening its corporate governance system in preparation for listing in the Colombo Stock Exchange (CSE).

You are required to:

- (a) **List** any two (02) key components of corporate governance. (02 marks)
- (b) **Explain** the role of risk management committee. (03 marks)
- (Total 05 marks)

Question 02

Greentech PLC, a renewable energy company, is preparing its ESG (Environmental, Social, and Governance) report for stakeholders. In order to enhance the credibility of the ESG information, **Greentech PLC** plans to engage an independent assurance provider.

You are required to:

Explain three (03) key elements of an assurance engagement with reference to the ESG report of **Greentech PLC**. (05 marks)

Question 03

FreshCart (Pvt) Ltd. is a growing online grocery delivery company. Customers place their orders through a mobile app, and the company promises same-day delivery. However, in recent months, customers have reported delays and wrong items in their deliveries. An internal review found that the problems may be due to issues between different business functions involved in handling orders.

You are required to:

- (a) **Identify** two (02) key business processes involved in the Company's operations. (02 marks)
- (b) **Explain** the importance of understanding these business processes as interconnected. (03 marks)
- (Total 05 marks)

Question 04

Eco Build (Pvt) Ltd. is a manufacturer of eco-friendly construction materials. Recently, an internal review revealed that purchase orders have been placed without proper approval, and goods received have not been verified against what was ordered. These issues have caused over-ordering, delays in supplier payments, and disputes about deliveries.

You are required to:

- (a) **Explain** two (02) key sub processes in the procurement process of **Eco Build (Pvt) Ltd.** (03 marks)
- (b) **State** two (02) internal controls that **Eco Build (Pvt) Ltd.** should implement to improve its procurement process. (02 marks)
- (Total 05 marks)

End of Section A

Three (03) compulsory questions**SECTION B**

(Total – 30 marks)

Question 05

Agro PLC is a leading agricultural business company. Currently, the company uses a partially integrated IT system, which requires manual interventions during the monthly financial statements closure process, particularly in account balance reconciliations.

Recently, there has been a delay in publishing interim financial results, which has raised concerns about insufficient resourcing within the finance team.

Additionally, several key finance staff members have left the company, aggravating the challenges. The Audit Committee is now concerned about the impact of these issues on the accuracy and timeliness of financial reporting and overall governance.

To address these concerns, the company is exploring digital transformation technologies.

You are required to:

- (a) **Identify** two (02) key activities involved in the financial statements closure process of **Agro PLC**.
(02 marks)
- (b) **Explain** the role of the Audit Committee in overseeing the financial statements closure process.
(03 marks)
- (c) **Discuss** how digital transformation technologies such as automation, artificial intelligence would optimize the financial statements closure process and strengthen governance at **Agro PLC**.
(05 marks)

(Total 10 marks)

Question 06

Stretch Apparels (Pvt) Ltd. is a Sri Lankan company that manufactures apparel for export market. Most of its products are exported to the United States (USA) and Europe. The Company has several factories located in Sri Lanka with a workforce of over 2,000 employees.

Recently, the U.S. government announced higher tariffs on clothes imported from other countries. At first, Sri Lanka was going to face a 44% tariff. After that, there was a 90-day pause, and during this time, all countries pay only a 10% tariff. This gives the Company some time to adjust.

An internal audit revealed several issues in the company's business processes, including:

- Mistakes in tracking customer orders.
- Fabric wastage during production.
- Delays in delivery caused by third-party transport providers.

The Company is also working on modernizing its operations by implementing AI based forecasting and a cloud-based ERP system. However, it recently experienced a phishing attack that targeted employees' data and costing data.

The Company has pledged to become more environmentally friendly. It plans to reduce water consumption by 30% and use eco-friendly dyes. But, new machines consume more electricity, making it more difficult to achieve these goals. The audit also revealed that some reports on the company's environmental efforts were incomplete and inaccurate.

You are required to:

- (a) Explain** two (02) business processes in the company that expose the company to risk, using the examples from the above scenario. (04 marks)
- (b) Explain** two (02) modern business risks that the company faces as a result of digital transformation and sustainability efforts. (03 marks)
- (c) Discuss** a measure taken for each of the risks identified in (b) above. (03 marks)

(Total 10 marks)

Question 07

T Zone (Pvt) Ltd. operates a chain of department stores in main cities of the island. Each store handles its own sales, cash collection, and stock management. Recently, the head office introduced a new set of internal controls to reduce errors and improve accountability. These include:

- All cash collected at the end of the day must be counted and signed off by two staff members.
- Inventory counts must be done weekly, and the results must be sent to the head office.
- Any discounts given to customers above a certain amount must be approved by a store manager.

The internal audit team has been asked to review whether these controls are well designed and whether they are being implemented in the stores. Management believes that better internal controls and regular audits will help the business to reduce losses, improve reporting accuracy, and strengthen overall financial performance.

You are required to:

- (a) **Explain** three (03) ways how internal controls and internal audits help **T Zone (Pvt) Ltd.** to manage its operations effectively. (06 marks)
- (b) **Discuss** two (02) techniques the internal audit team can use to test whether the daily cash handling control is designed effectively. (04 marks)
- (Total 10 marks)

End of Section B

Two (02) Compulsory questions

(Total – 50 marks)

SECTION C

Question 08

Fresh Mart (Pvt) Ltd. is a newly established supermarket chain operating 12 outlets across Sri Lanka. The company offers groceries, household items, and fresh produce, with daily sales made through both cash and electronic payments. As part of its expansion strategy, the company is seeking a significant bank loan to open five new stores and upgrade its logistics infrastructure. The bank requires the submission of audited financial statements for the year ended 31st March 2025.

This will be the company's first statutory audit, and the directors have appointed **PQR & Co.**, Chartered Accountants to conduct the audit.

During the initial engagement meeting, the audit partner noted the following:

- The Finance Department is small, and key accounting duties are shared among a few employees. The staff have limited audit experience.
- A new Point-of-Sale (POS) and inventory management system were introduced in November 2024. Some outlets have struggled to fully integrate the system, and physical inventory often does not match system's records.
- Each store handles hundreds of transactions daily, mostly through cash, cards, and mobile wallets. The company does not use independent cash reconciliation controls at every outlet.
- The management has made estimates for stock shrinkage and reduction, provisions for outdated items, and doubtful trade receivables. These figures could significantly affect reported profit.

- There have been reports of inventory theft and unrecorded sales at two outlets. Although management initiated an internal review, it has not yet been concluded or documented.
- The audit must be completed within six weeks to meet the bank's loan processing timeline.

The audit team is now preparing for the planning phase, which includes gaining an understanding of the business and assessing risks. The engagement partner has instructed the team to follow the relevant Sri Lanka Auditing Standards (SLAuSs) throughout the audit and instructed to ensure proper documentation and reporting.

You are required to:

- Explain** three (03) responsibilities of the independent auditor of **Fresh Mart** for the audit of year ended 31st March 2025. (06 marks)
 - Discuss** two (02) essential elements that should be agreed upon in the audit engagement letter with **Fresh Mart** for the year ended 31st March 2025. (04 marks)
 - Explain** three (03) key steps the auditors of **Fresh Mart** should follow as part of audit planning (i.e., in developing overall strategy and detailed audit plan). (05 marks)
 - Explain** two (02) factors the audit engagement team should consider when determining materiality for the audit of **Fresh Mart (Pvt) Ltd.** (03 marks)
 - Explain** the auditor's responsibility for identifying and responding to the risk of fraud during the audit. (03 marks)
 - Explain** two (02) procedures the audit team might use to understand **Fresh Mart** and its environment. (04 marks)
- (Total 25 marks)

Question 09

Med Care (Pvt) Ltd. (*the Company*) operates a chain of private hospitals and specialist medical centers across Sri Lanka. The Company offers general and surgical care, laboratory testing, and outpatient services. With demand for private healthcare increasing, the company has expanded to six hospitals and is planning to open two more by early 2026.

In light of recent industry risks, with the introduction of new personal data protection law in Sri Lanka, the Board of Directors has discussed implementing an Enterprise Risk Management (ERM) framework. Currently, risk management is done informally at the departmental level, and not integrated into the company's strategic planning or governance process.

The Audit Committee is considering whether to establish an Internal Audit (IA) function. Some board members believe it will strengthen oversight, especially in clinical operations and procurement. However, the CEO believes departmental checks are sufficient and IA would be an unnecessary expense.

Meanwhile, the company has reappointed **Asoka & Co.**, Chartered Accountants as their external auditor. During the planning stage, the audit partner identified the following issues:

- The engagement partner for the company has held this role for seven consecutive years and has developed a close relationship with the CFO, who previously worked at **Asoka & Co.**
- One junior audit team member accepted a gift voucher from the company's HR department as a "thank you gesture" for assisting during the audit planning phase.
- The audit firm has experienced high staff turnover, affecting engagement quality reviews and continuity.

The partner has reminded the team to maintain compliance with the Code of Ethics for Professional Accountants and quality control standards throughout the engagement.

You are required to:

- (a) **Explain** three (03) ways in which integrating Enterprise Risk Management (ERM) into **Med Care (Pvt) Ltd.'s** business processes could enhance its operations. (06 marks)
- (b) **Explain** two (02) benefits of embedding ERM into **Med Care (Pvt) Ltd.'s** operations, strategic planning, or governance. (04 marks)
- (c) **Explain** the internal audit process that **Med Care (Pvt) Ltd.** could follow if it introduces an internal audit function. (04 marks)
- (d) **Explain** two (02) reasons why **Med Care (Pvt) Ltd.** might need to establish an internal audit function. (04 marks)
- (e) **Explain** two (02) ethical threats found in the audit of **Med Care (Pvt) Ltd.** along with its impact on the audit. (04 marks)
- (f) **Recommend** two (02) safeguards the audit firm can implement to reduce or eliminate the threats identified in part (e) above. (03 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.

Level	Action Verb	Definition	Detailed Instructions for Students
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.



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CURRICULUM 2025

SUGGESTED ANSWERS

Level 03

3803 - RISK, CONTROLS & AUDIT (RCA)

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Four (04) Compulsory questions

(Total – 20 marks)

SECTION A

Answers for Question 01

Unit 1 – Governance Framework

Learning outcome - Explain components of Corporate Governance with committees.

- Explain the role of Corporate Governance in supporting effective risk management.

(a) Components of corporate governance:

- Board of Directors.
- Stakeholder Engagement.
- Transparency & Disclosure.
- Internal Control Systems.
- Ethical Corporate Culture.
- Accountability.

(1 mark each, 02 marks)

(b) Risk management committee:

The Risk Management Committee identifies, evaluates, and monitors risks that could impact the business. It develops strategies to mitigate these risks and ensures the company operates within acceptable risk levels by reviewing risk assessments. Also, risk management committee assists Board of Directors in fulfilling its oversight responsibilities regarding risk appetite and governance structure. This helps to protect assets, maintain operational stability, and enhance long-term sustainability.

(03 marks)

(Total 05 marks)

Answers for Question 02

Unit 4 – Assurance Engagements and Related Services.

Learning outcome – Explain the key elements of an assurance engagement and relate the elements.

The key elements of an assurance engagement in the context of **Greentech PLC's** ESG report are:

- (1) **Three-party relationship:** The assurance practitioner (independent auditor), the responsible party (**Greentech** management is preparing the ESG report), and the intended users (stakeholders relying on the ESG information).
- (2) **Subject matter:** The ESG data and disclosures contained in the report.
- (3) **Suitable Criteria:** The standards or frameworks against which the ESG data is assessed, such as GRI Standards or SLFRS S 1.
- (4) **Evidence:** The information collected by the assurance provider through testing and evaluation to support the conclusions.
- (5) **Assurance report:** The conclusion provided by the assurance provider expressing the reliability of the ESG report, enhancing stakeholders' confidence.

(02 marks each, 05 marks)

Answers for Question 03

Unit 2 – Business Processes in Business Organizations.

Learning outcome – Identify the business processes and explain the importance: understanding the organization as a system of interconnected processes.

(a) **Business processes:**

- Order management – receiving and processing customer orders.
- Inventory management – Checking item availability and preparing items for dispatch.
- Delivery process.
- Cash management.
- Procurement management.

(01 mark each, 02 marks)

(b) Importance of interconnected business processes:

- These processes are closely linked. If order management sends incorrect or delayed order details, the Inventory team may pack the wrong items or face stock issues.
- This then affects the **Delivery Process**, causing delays or mistakes.
- Understanding the interconnection helps ensure coordination across departments, reduces errors, and improves customer satisfaction.

(01½ marks each, 03 marks)

(Total 05 marks)

Answers for Question 04

Unit 2 – Business Processes in Business Organizations.

Learning outcome – Discuss the key business processes (procurement process, payroll process, cash management process, inventory management process and property, plant and equipment process) in business organizations.

(a) Key sub processes in the procurement process:

- **Purchase Requisition** – A request is made by a department to buy goods or services.
- **Ordering process** - The procurement team generates a Purchase Order, which should be approved before sending to suppliers.
- **Receipt of goods** – When the goods arrived, received items are checked against the Purchase Order and delivery note to ensure correct quantities, items were delivered before accepting them as inventories.

(01½ marks each, 03 marks)

(b) Controls:

- Authorization Control on Purchase Orders.
- Purchase request approval.
- Three-Way Matching before making payments.
- Approve the GRN by a designated officer after verifying the receipt of goods as per the Purchase Order placed.

(01 mark each, 02 marks)

(Total 05 marks)

End of Section A

Answers for Question 05

Unit 2 – Business Processes in Business Organizations.

- Learning outcomes** - Identify and describe critical governance processes, including the related party transactions and the financial statement disclosure process, emphasizing their role in ensuring the organization's compliance, transparency and accountability.
- Explain the role of digital transformation technologies (including automation, artificial intelligence, and machine learning) in optimizing business processes.

(a) Key activities involved in the financial statements closure process:

- Verifying data accuracy and completeness through reconciliation process.
- Passing adjusting journal entries (closing entries) – Adjusting Journal Entries.
- Preparation and Review of Financial Statements.

(01 mark each, 02 marks)

(b) The role of Audit Committee:

- Monitoring the financial reporting process to ensure timely and accurate financial reporting and ensure the compliance with applicable accounting standards.
- Overseeing the adequacy of resources and competencies within the finance team, recommending management actions if gaps are identified.
- Ensuring that internal controls remain effective and that risks related to staff turnover are mitigated, possibly by supporting process automation or training. Also it assesses whether adequate internal control over financial reporting are existing.

(01½ marks each, 03 marks)

(c) Digital Transformation:

- Reducing manual workload and dependency on key staff by streamlining reconciliations and report generation.
- Identifying anomalies and ensuring data integrity, providing alerts that compensate for reduced manpower specially when AI is used.
- Analyzing patterns to predict bottlenecks and recommend process improvements, enhancing the speed and accuracy of closure.
- Using advanced integration tools or Enterprise Resource Planning (ERP) systems can minimize manual reconciliation needs and ensure seamless data flow, reducing errors and improving the timeliness of financial reports.
- Routine tasks could be handled efficiently and effectively if technologies such as Robotic Process Automation (RPA) is used and this will reduce the number of man hours required for routine tasks.

(02½ marks each, max. 05 marks)

(Total 10 marks)

Answers for Question 06

Unit 2 – Business Processes in Business Organizations.

Unit 3 – Risk Management Framework and Internal Control System.

- Learning Outcomes** - Identify the business processes and explain the importance understanding the organization as a system of interconnected processes
- Explain modern business risk related to digital transformation & sustainability.
 - Identify the relationship between business processes and risk exposure.

(a) Business processes exposed to risks:

- **Order Tracking Process:** Mistakes in tracking customer orders may lead to delays or incorrect shipments. This affects customer satisfaction and risks losing buyers in export markets and potential loss of future orders.
- **Production Process – Fabric Usage:** Wasting fabric during production increases material costs. It also indicates a risk to profitability, especially during uncertain pricing conditions like the current tariff pause.
- **Delivery & Logistics Process:** Late deliveries caused by third-party transporters can lead to missed deadlines and penalties. This exposes the company to reputational and contract risks.

(02 marks each, maximum 04 marks)

(b) Modern risks:

- **Digital Risk** – Cybersecurity Breach: A phishing attack affected employee and costing data. This puts sensitive information at risk and may cause financial or legal problems.
- **Sustainability Risk** – Energy Usage vs. Environmental Goals: The company wants to reduce water consumption and be eco-friendly, but new machines are using more electricity. This may prevent the company from reaching its sustainability targets, dissatisfying buyers.

(01½ marks each, 03 marks)

(c) Measures – Modern risks:

Risk	Control
Digital risk	<ul style="list-style-type: none">• Introduce two-factor authentication and conduct regular cybersecurity training for employees. Implement regular system audits to prevent phishing attacks and protect data. Two factor authentication adds an additional layer of protection beyond putting a password, making unauthorized access more difficult even if user credentials are stolen. Employee training increases awareness of cyber threats like phishing and promotes digital practices, thereby reducing the likelihood of successful cyber-attacks.• More awareness of the risks and measures the employees should be taken.
Sustainability risk	<ul style="list-style-type: none">• Install energy monitoring systems and update sustainability reporting processes to give accurate and timely data. Energy monitoring systems help to track actual electricity consumption, making it easier to identify inefficiencies and take corrective actions. Accurate data also ensures the sustainability reports reflect actual performance reducing risk of misleading claims and aids company in maintaining credibility with stakeholders.• Consider using alternative energies e.g. green energy, which will cause less damage to the environment.

(For one measure under each risk, 1.5 marks, totaling to 03 marks)

(Total 10 marks)

Answers for Question 07

Unit 3 – Risk Management Framework and Internal Control System.

- Learning outcome** - Explain the relationship among risks, internal controls and audits.
- Discuss the techniques used to test the design effectiveness of Controls.

(a)

- Internal controls are procedures that help a company to run its operations properly by reducing risks, errors and preventing fraud. In the case of this company, controls like having two employees count and sign off cash at day end help to ensure accuracy in handling money and minimize risks of theft or misappropriation.
- Weekly inventory counts will help to detect any differences or missing stocks, which enhances inventory accuracy and helps to prevent losses due to theft or poor handling.
- Internal audits help the company by checking that these controls are implemented as intended. The audit team can review if stores are following the new procedures and may recommend further improvements.
- Together, internal controls and internal audits help the company to manage its operations effectively by improving accuracy, reducing mistakes / errors, and making sure controls are followed across all stores. Also helps management to make informed business decisions. Routing audits promote a culture of accountability, responsibility among the staff and help operations are consistent with policies.

(03 marks each, 06 marks)

(b) **Techniques to test operating effectiveness**

- (i) **Inquiry:** Inquiries are made of employees about how they perform the cash count to confirm the process is understood. Also they can understand whether employees are aware and apply control procedures.
- (ii) **Inspection :** Check the cash count sheets to verify two employees sign off daily. Also audit team can inspect documents such as reconciliation records and bank deposit slips. They can check whether dual controls are existing, check calculations accuracy and whether cash recorded are matching with cash deposited to the bank.
- (iii) **Walkthrough:** Physically observe the cash-counting process at day end to see if the control is actually followed. Auditor can watch whether two staff members are actually counting and signing off the cash as required.

(02 marks each, 04 marks)

(Total 10 marks)

End of Section B

Two (02) Compulsory questions

(Total 50 marks)

SECTION C**Answers for Question 08****Unit 5 – Risk Assessment, Audit process, and Audit Reporting.**

- Learning outcomes** - Explain the overall objectives of the independent auditor and conduct the audit by SLAuSs and agreeing the terms of audit engagement (SLAUS 200 & SLAUS 210).
- Explain planning the audit of the financial statements (SLAUS 300).
 - Discuss the procedures used in obtaining audit evidences in establishing the assertions (SLAUS 500)
 - Explain audit materiality & audit documentation (SLAUS 320 & SLAUS 230).
 - Define fraud risk and explain auditors' responsibility for preventing and detecting fraud in an audit of financial statements (SLAUS 240)

(a) Responsibilities of the auditor:

- **Obtain reasonable assurance** - The auditor must obtain reasonable assurance that the financial statements of **Fresh Mart** for the year ended 31st March 2025 as a whole are free from material misstatement, whether caused by fraud or error. Specially in **Fresh Mart** as per the initial information gathered, need to ensure the audit is well planned and designed to address the possible misstatements arising due to the fraud risks and possible control deficiencies / absence of controls.
- **Express an opinion** - Based on the audit evidence, which should be sufficient and appropriate, the auditor must express an opinion on whether the financial statements are prepared in accordance with the applicable financial reporting framework (SLFRS for SMEs or Full SLFRS as applicable).
- **Comply with SLAuSs** - The auditor must conduct the audit in accordance with Sri Lanka Auditing Standards (SLAuSs), including ethical requirements such as independence and professional skepticism.

- **Identify and assess risks** - The auditor must assess risks of material misstatement. At **Fresh Mart**, risks include inaccurate inventory, unrecorded sales, and management estimates.
- **Report appropriately** - The auditor must issue a written audit report communicating the opinion and any issues found during the audit process.

(02 marks each, 06 marks)

(b) Engagement Letter:

- Objective and scope of the audit – The letter should be clearly mentioned that the objective is to provide independent audit opinion on the financial statements.
- Auditor’s responsibilities - About the audit evidence gathering and then forming an opinion on the financial statements. It should highlight that the auditor is responsible to carry out audit in accordance with SLAuS and obtain reasonable assurance.
- Management’s responsibilities, including providing access to records and preparation of financial statements, the responsibility of preventing and detecting fraud, and implementing relevant controls over financial reporting.
- Applicable financial reporting framework – The management responsibility is to prepare the financial statements as per the applicable financial reporting framework and auditor’s to form an opinion on whether the financial statements have been prepared in accordance with the applicable financial reporting framework.
- References to the expected form and content of any reports to be issued by the auditor - Provide reference that the financial statements audit will be conducted in compliance with the Sri Lanka Auditing Standards.

(02 marks each, 04 marks)

(c)

- Understanding the client's business and environment, industry, specially since this is a newly established the competition, the strategies in place etc.
- Identifying the risks arising based on the understanding, particularly the significant risks that will lead to material misstatements in the financial statements. E.g. in this case there are some indicators of heightened fraud risk due to not having appropriate controls in place.
- Determining the materiality levels to determine scoping based on business understanding and financial performance (quantitative and qualitative factors)
- Assigning appropriate staff. As there is a new system implementation whether the IT specialist required or any other specialists are required to be assigned.
- Develop the audit plan including nature, timing and extend of audit procedures.

(02 marks each, 05 marks)

(d) **Determination of materiality:**

- **The size and nature of the business: Fresh Mart** is a retail company with high transaction volume and relatively low margins. Common benchmarks like total revenue, gross profit, or net profit should be evaluated to determine what level of misstatement would be material to users of the financial statements.
- **Risk of misstatement in specific areas (qualitative factors):** The team should consider areas with higher inherent risk, such as inventory shrinkage and management estimates. Even small misstatements in high-risk areas (e.g. fraud-prone cash sales or unrecorded revenue) could be material due to their impact on decision-making.
- Given that **Fresh Mart** is still in the first year of operations, the suitability of the benchmark to be assessed e.g. whether the profit reflective of the appropriate benchmark based on the performance of the company in its first year.

(1½ marks each, 03 marks)

(e)

- Obtain reasonable assurance that the financial statements taken as a whole are free from material misstatement whether caused by fraud or error. Specially considering the reports of theft and unrecorded sales, the auditor must perform specific procedures (e.g. surplus cash counts, reconciliations) to address the risk of fraud
- Maintain professional skepticism, perform risk assessment, and design audit procedures to respond to identified fraud risks and alert on the indicators of the risk of fraud throughout the audit engagement.

(03 marks)

(f) **Procedures:**

- **Review internal documents** - Analyze financial statements, policies, organizational structure and internal control documents.
- **Observed operations** - Visit some outlets and observe cash collection, inventory handling and how they use new POS system.
- **Inquiries of Management and Staff** - Ask about the implementation of the POS system, internal reviews on theft, and how estimates were made.
- **Analytical Procedures** - Compare sales or gross margin trends across outlets, especially where unrecorded sales or inventory shrinkage is suspected.
- Perform industry analysis to understand market condition, regulatory requirements, economic factors affecting industry.

(02 marks each, 04 marks)

(Total 25 marks)

Answers for Question 09

Unit 6 – Fundamentals of Enterprise Risk Management (ERM).

Unit 7 – Fundamentals of Internal Audit.

Unit 8 – Ethical Requirements and Quality Requirements of an Audit of Financial Statements.

Learning Outcomes - Explain the integration of ERM into key business processes.

- Identify the benefits of embedding ERM into operational, strategic, and governance frameworks.
- Explain the internal audit process, including frameworks and techniques.
- Explain the factors to be considered in assessing the need for an internal audit.
- Identify threats to compliance with the fundamental principles and evaluate the significance of the threats identified.
- Apply safeguards to eliminate/reduce the threats to an acceptable level.

(a) ERM Integration:

ERM can be integrated into **Med Care's** business by including risk management in daily activities and decision-making.

- **Increase efficiency and risk conscious culture:** Identifying risks related to patient care, equipment failures, or service delays. Applying ERM across departments helps to eliminate repetitive or inconsistent risk management practices. It builds companywide risk awareness culture and helps to prevent breakdown in operations.
- **Strong regulatory compliance and security:** Monitoring adherence to healthcare regulations and licensing requirements. With personal data protection laws now in effect ERM help **Med Care** stay ahead of compliance requirement. A well-integrated ERM system ensures the privacy and regularly reviewed and managed across department reducing chance of legal breaches.
- **Better decision-making support:** Considering risks when opening new hospitals or investing in new systems. By using structured ERM approach company can more effectively recognize and evaluate risks throughout the organization. This enable leadership to make smarter choices by clearly understanding challenges and opportunities.

(02 marks each, 06 marks)

(b) Benefits of embedding ERM:

Operational benefit: Helps to reduce service interruptions, improve patient safety and identify risks such as staff shortages or supply chain issues.

Governance benefit: Gives the board and Audit Committee better visibility into risks, enabling more informed decision-making and oversight.

Alignment of risk with strategic goals: ERM helps to ensure that key strategic initiative such as hospital expansion or adoption of new technologies are evaluated referring to risk impact, allowing board of directors to make realistic and sustainable plans.

(02 marks each, 04 marks)

(c) Internal audit process:

The internal audit process includes:

- **Planning** – Define the audit scope and objectives, identify risk prone areas e.g. clinical billing or procurement, data protection.
- **Fieldwork** – Collect evidence through interviews, system walkthroughs, and document reviews to assess whether internal controls are working effectively.
- **Reporting** – Summarize findings and recommend improvements. Communicate findings to management and audit committee through reports by including weaknesses and recommended corrective actions.
- **Follow-up** – Review whether actions were taken to correct the issues within the recommended timelines to ensure continuous improvement.

(01 mark for each, 04 marks)

(d) Establishing an internal audit function:

- **Healthcare industry complexity:** As **Med Care** expands, its operations will become more complex. Specially in areas like procurement medical services. Hospitals are regulated, and errors (e.g. in treatment or billing) can have serious consequences. Internal audits can help to ensure controls are in place and ensure the potential risks in these critical areas are identified and addressed.

- **Expansion and decentralization:** With more hospitals planned, operations become harder to monitor centrally. Internal audit provides independent assurance across different locations.
- **Ensuring legal and Regulatory Compliance:** Since the company handles confidential patient information and internal audit team can help to ensure **Med Care** is meeting the requirement of new data protection laws and industry regulations. This will reduce likelihood of facing penalties, legal issues or damage to reputation.

(02 marks each, 04 marks)

(e) Ethical threats:

- **Familiarity threat:** The audit partner has worked on the **Med Care** audit for seven consecutive years and is close to the CFO. This could impair objectivity and independence, professional skepticism.
- **Self-interest threat:** A team member accepting a gift voucher from client's HR department may create bias or the appearance of bias, especially if the gesture influences their work. This will create self-interest threat as the personal benefit may influence the auditor's objectivity and reduce the ability to remain impartial or question the client's actions effectively.

(02 marks each, 04 marks)

(f) Safeguards:

- (1) **Rotation of engagement partner:** Rotate the engagement partner to reduce familiarity and bring fresh perspective to the audit.
- (2) **Implement firm-wide gift policy and Disciplinary Actions:** Implementing a clear strict policy regarding the acceptance of gifts, including setting a nominal value threshold in accepting such gifts and provide training on professional ethics to ensure all team members understand and adhere to the Code of Ethics of Professional Accountants.

(01½ marks each, 03 marks)

(Total 25 marks)

End of Section C