

EXAMINER'S REPORT**LEVEL III EXAMINATION - JANUARY 2026****(303) FINANCIAL CONTROLS & AUDIT**

Section A**Question No. 01**

This question consisted of two parts and assessed candidates' knowledge of business organizations in Sri Lanka. **Part (a)** required candidates to list three types of business organizations operated in Sri Lanka. Almost all candidates attempted this part, and the majority scored full marks, reflecting a good general understanding of the topic.

Part (b) asked candidates to identify the most suitable type of business organization that Sunil and his wife could start based on their requirements. While the majority answered correctly, a few candidates incorrectly identified a partnership or sole proprietorship as the most suitable structure; however, both do not offer limited liability protection.

As a whole, performance for this question was at a satisfactory level.

Question No. 02

This question required candidates to state both internal and external risks associated with investing in a new solar power project. All candidates attempted the question and provided satisfactory answers.

Majority of candidates demonstrated a reasonable understanding of risk identification. However, a common weakness observed was that some candidates confused internal risks with external risks, indicating a lack of clarity in distinguishing between risks that originate within the organization and those arising from the external environment.

As a whole, performance for this question was at a satisfactory level.

Question No. 03

This question consisted of two parts. In **part (a)**, candidates were required to state three differences between a "Reasonable Assurance Engagement" and a "Limited Assurance Engagement." In **part (b)**, candidates were required to explain the most appropriate type of assurance based on the information given.

Most candidates attempted **part (a)**, and the majority scored full marks, demonstrating a sound understanding of the theoretical content. However, a few candidates limited their responses to definitions alone, which was insufficient to attain full marks.

Part (b) required candidates to apply the knowledge from **part (a)** to select the most appropriate type of assurance for the given scenario. An average number of candidates simply stated “limited assurance engagement” without providing any explanation or reasoning, which prevented them from earning the maximum marks available.

As a whole, performance for this question was at a satisfactory level.

Question No. 04

This question consisted of two parts: **part (a)** and **part (b)**. A significant proportion of candidates did not attempt this question. **Part (a)** required candidates to state the objective of a system of quality control. Among those who attempted **part (a)**, the majority provided incomplete or irrelevant responses, indicating either insufficient knowledge of the topic or a misunderstanding of the question requirements. As a result, most of the candidates who attempted this part failed to score the marks available.

In **part (b)**, the majority of candidates performed considerably well by correctly stating two policies and procedures that need to be considered for the quality control of individual engagements. However, a few candidates provided general audit procedures rather than the specific policies and procedures required, which resulted in no marks being awarded.

As a whole, performance for this question was at a moderate level.

Section B

Question No. 05

This was not a particularly complex question, consisting of three parts with a total of 10 marks. **Part (a)** asked candidates to identify three matters arising from the described scenario that the auditor needs to understand when performing the audit. The majority of candidates attempted this part and successfully scored the allocated marks.

Part (b) required candidates to state four specific audit procedures to be performed when auditing the revenue of **Rikzo PLC**. An average number of candidates failed to answer this part adequately, instead providing vague responses such as checking, enquiry, and computation.

Part (c) asked for a theoretical explanation of the meaning of sufficiency and appropriateness of audit evidence. While most candidates attempted this part and earned full marks, some provided irrelevant or unclear explanations. A few candidates demonstrated understanding but articulated their answers poorly, while others included unrelated points.

As a whole, performance for this question was at a moderate level.

Question No. 06

This was a well-constructed question that effectively assessed candidates' knowledge of how to form an audit opinion under different scenarios. Despite its importance, overall performance of the candidates was weak.

Part (a) (i) required candidates to assess the impact of the impairment of debtors, as per the given scenario, on the auditor's report. This part presented a scenario involving a scope limitation arising from issues with a newly implemented Enterprise Resource Planning (ERP) system, which affected the generation of an accurate debtor ageing analysis. While a considerable number of candidates attempted this part, the majority failed to correctly identify and apply the concept of scope limitation.

Most candidates recognized that the required provision of Rs. 6 million exceeded the materiality threshold of Rs. 5 million and acknowledged the system-related issues. However, they concluded with a qualified opinion without adequately addressing the pervasive nature of the limitation, even though debtors represented 23% of total assets, a figure significant enough to warrant consideration of a disclaimer of opinion. Furthermore, candidates largely failed to discuss pervasiveness as a determining factor in selecting the appropriate type of modified opinion, which was a key expectation of this part.

Part (a) (ii) required candidates to identify a management disagreement and determine the appropriate audit opinion in response. A considerable number of candidates attempted this part, with the majority recognizing that a modified opinion was required, given that the required provision of Rs. 12.5 million exceeded the materiality threshold of Rs. 5 million, along with the ERP system's failure to generate an accurate stock ageing analysis. Some candidates correctly identified this as requiring a qualified opinion, while others suggested an adverse opinion.

Candidates are strongly encouraged to develop a deeper understanding of audit opinion types, the concept of pervasiveness, and the distinction between scope limitations and management disagreements, as these are fundamental competencies in audit and assurance.

Part (b) was intended to be straightforward, requiring candidates to explain an unmodified audit opinion. The majority of candidates were unfamiliar with the correct definition and instead provided responses based on a literal interpretation of the term "unqualified," describing it simply as a clean or unmodified opinion without demonstrating any technical understanding. This suggests a significant gap in candidates' foundational knowledge of audit reporting terminology and standards.

As a whole, performance for this question was at a moderate level.

Question No. 07

Part (a) required candidates to explain two circumstances or relationships that could be recognized as possible threats to the auditor's independence in the given scenario. Overall performance was satisfactory, with most candidates identifying at least two relevant instances. Commonly cited threats included the firm's over-reliance on **Marvel PLC** as a source of fees (representing 23% of total income) and the acceptance of internal audit services for the same client.

Part (b) asked candidates to assess two threats to auditors' compliance with the fundamental principles of ethics, with reference to the scenario. The majority of candidates correctly linked the self-interest threat arising from 23% fee dependency, the familiarity threat from the 25-year continuous audit tenure, and the self-review threat resulting from performing the internal audit of a significant subsidiary and providing recommendations to address process weaknesses. However, a significant number of candidates simply repeated their answers from **Part (a)** without relating the identified issues to the specific fundamental principles of ethics, which limited the marks they could achieve.

Part (c) required candidates to identify three safeguards to eliminate or reduce the threats identified in **part (b)** to an acceptable level. This section was the weakest performing across all three parts. Most candidates provided only superficial responses, such as declining the internal audit engagement or reducing fee dependency, without offering technically sound or comprehensive safeguards. Only a small number of candidates addressed this part correctly and scored full marks.

As a whole, performance for this question was at a moderate level.

Section C

Question No. 08

This 25-mark question was divided into five parts, assessing candidates' understanding of auditing in a manufacturing environment, with particular attention to different processes. The scenario was practical and reflective of the current business environment, requiring candidates to apply theoretical knowledge and evaluate issues across various processes.

Part (a) required candidates to state preventive and detective controls that could be used. **Part (b)** required candidates to explain three control activities within the inventory management process of **Duro (Pvt) Ltd.**, including the purpose of each identified control activity. **Part (c)** asked candidates to explain the objectives of an internal control system. **Part (d)** required candidates to identify business risks associated with the procurement process. Finally, **part (e)** asked candidates to state general IT controls that could be implemented by **Duro (Pvt) Ltd.**, providing an example for each.

The responses indicated that many candidates were familiar with the question structure. While most candidates attempted the question and performed reasonably well in **parts (a), (b), and (d)**, responses to **parts (c) and (e)** were weaker, likely due to misunderstandings or a lack of familiarity with these specific areas.

- (a)** Most of the Candidates' responses were generally satisfactory. However, despite the theoretical and straightforward nature of the question, many confused "Preventive Controls" with "Detective Controls" and vice versa.
- (b)** This part was well answered by many candidates. However, some candidates failed to score full marks because they did not correctly match the purposes of the controls to the inventory management process explained.
- (c)** Candidates' performance was slightly weaker compared to parts (a) and (b), despite this being a theoretical question. Some candidates only mentioned answers such as reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations, without providing explanations.
- (d)** It was observed that most candidates were familiar with the procurement process, and an average number of candidates scored well on this part.
- (e)** Although this was a general question testing candidates' IT knowledge, most candidates failed to score full marks. However, a few earned partial marks by correctly stating either a control or an example.

As a whole, performance for this question was at a moderate level.

Question No. 09

This 25-mark scenario-based question was designed to assess candidates' audit skills and their understanding of key areas of audit knowledge. The scenario described the initial audit of **D&Y Associates** and covered a broad range of areas, requiring candidates to carefully analyze the information provided and identify the key matters to be considered in conducting the audit.

- (a)** Most candidates attempted this straightforward question, identified matters from the scenario, and provided satisfactory answers. However, a few candidates misunderstood the requirement and failed to link the risk areas to the scenario.
- (b)** This part of the question required candidates to state four factors that may affect the identification of materiality based on an appropriate benchmark for **Reko PLC**. Most candidates were unable to provide correct answers and instead focused on balance sheet elements, resulting in poor responses.

- (c) This question was divided into two parts. **Part (i)** required candidates to state two factors that may indicate a significant risk, while **part (ii)** asked them to explain the main fraud risk relevant to the audit of **Reko PLC**, based on the scenario provided. Almost all candidates attempted the question; however, most were unable to provide satisfactory answers, reflecting a general lack of knowledge in this area. Only a few candidates performed well, successfully identifying and explaining a critical fraud risk area of revenue recognition. Some candidates also identified other fraud risks, including mixed inventory issues, unreconciled inventory balances, performance-based incentive arrangements, and related-party transactions, including management fees.
- (d) This part of the question required candidates to state five matters to inquire from **Reko PLC's** management to identify fraud-related misstatement risks. Most candidates provided general audit inquiries unrelated to fraud or the scenario, with very few including relevant fraud-focused points.
- (e) This part required candidates to state five audit procedures to be performed in relation to the related-party transactions of **Reko PLC**. Although a considerable number of candidates attempted this part of the question, the responses were generally poor. Most candidates provided general audit procedures rather than those specifically applicable to related-party transactions, indicating that this continues to be a weak area among candidates.

As a whole, performance for this question was at a moderate level.

Suggestions to enhance the Competency Level of Candidates in order to Improve the Performance at the Examination:

- (1) Candidates must study the study text and understand its contents.
- (2) Refer articles, magazines in relation to this subject and other reading materials related to auditing.
- (3) Understand the definition of action verbs and practice to answer the questions based on the action verb list given at the end of the question paper.
- (4) Study the contents of the past papers and practice at least last 2-3 years' examination papers and try to understand the way in which the questions are being set.
- (5) The candidates should understand the relationship between the theory given in the question papers and examiner's expectation of its application at the examination.
- (6) The candidates should study and understand as to what areas in the study text have been tested in the past question paper and make short notes of those areas in the study text.
- (7) The candidates should work out the past paper questions on timely basis before the examination, it will improve the time management at the examination.
- (8) Write short notes of each study chapter given in the study text and study as and when you get free time to remember the contents of syllabus.
- (9) Candidates should write legible hand writing at the examination.
- (10) The candidates should carefully read the instructions given in the examination paper prior to start answering the questions in the paper.
- (11) The candidates should have a clear and balance mind set at the examination in order to understand the question and provide with appropriate and accurate answers required in the question.
- (12) The candidates should allocate the time for the questions based on the marks given and accordingly, the candidate should be able to answer all the questions given in the paper effectively.
- (13) Check twice whether all required questions were answered and appropriately numbered prior to hand over the answer scripts.

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