



ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

LEVEL III EXAMINATION - JULY 2025

(303) FINANCIAL CONTROLS & AUDIT

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

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

26-07-2025
Afternoon
[01.45 – 05.00]

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

No. of Pages : 07

No. of Questions : 09

- (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

Corporate Governance is the system by which companies are directed and controlled. Good corporate governance is important because the owners of a company and the people who manage the company are not always the same. As per the Code of Best Practice on Corporate Governance, an Audit Committee should be established by a listed company.

You are required to:

- (a) **State** three(03) advantages to a company following the Good Corporate Governance Principles. (03 marks)

- (b) **State** two(02) functions of the Audit Committee. (02 marks)

(Total 05 marks)

Question 02

An audit firm shall establish and maintain a system of quality control that includes policies and procedures. Human Resources and relevant ethical requirements are key elements of a system of quality control.

You are required to:

- (a) **Explain** “Relevant Ethical Requirements” as an element of a system of quality control. (03 marks)

- (b) **Identify** two(02) ways that competence of human resources of an audit firm can be developed. (02 marks)

(Total 05 marks)

Question 03

Reliance Construction (Pvt) Ltd. is engaged in construction business and your audit firm is the external auditor of this company over last five years. **Reliance Solar (Pvt) Ltd.** was incorporated on 01st April 2024 and it is a subsidiary company of **Reliance Construction (Pvt) Ltd.** However, their application to register with Sri Lanka Sustainable Energy Authority has been rejected as **Reliance Solar (Pvt) Ltd.** has failed to recruit qualified engineers for facilitating the operations. Further, **Reliance Solar (Pvt) Ltd.** has almost completed three (03) projects and indicates a remarkable profit margin compared to the operating losses of **Reliance Construction (Pvt) Ltd.**

The management of **Reliance Solar (Pvt) Ltd.** appointed your audit firm to conduct the audit of financial statements for the year ended 31st March 2025 of **Reliance Solar (Pvt) Ltd.** as the external auditor.

You are required to:

- (a) **Explain** two(02) important aspects that the auditor shall consider before accepting the audit engagement of **Reliance Solar (Pvt) Ltd.** (03 marks)
 - (b) **List** two(02) examples for assurance engagements other than an audit engagement. (02 marks)
- (Total 05 marks)

Question 04

Shopping.lk, an e-commerce company operates in a highly competitive market where maintaining a strong competitive edge is crucial. The company faces the risk of losing its market share due to intense competition and rapidly changing consumers' preferences. **Shopping.lk** has identified that strategic planning, careful risk identification and timely assessment are essential to face the competition. This company already uses social media for marketing and promotional activities, and now intends to leverage social media further as a risk management tool.

You are required to:

- (a) **Explain** how social media will be an effective risk management tool for **Shopping.lk.** (03 marks)
 - (b) **Identify** two(02) techniques used in mitigating risks of **Shopping.lk.** (02 marks)
- (Total 05 marks)

End of Section A

SECTION B

(Total 30 marks)

Question 05

Sun Power Solutions (Pvt) Ltd. (SPS) is engaged in the business of importing solar panels and selling in the local market. There is a significant demand for these items in the local market and **SPS** is planning to obtain a loan of Rs.200 million from the bank. The bank has requested to submit the audited financial statements to process the loan.

You are the Audit Senior to conduct the audit of the financial statements for the year ended 31st March 2025 of **SPS**.

The draft income statement prepared by **SPS** is as follows:

(Rs.'000)

For the year ended 31st March	2025 (Draft)	2024 (Audited)
Revenue	350,355	390,125
Cost of Sales	(256,474)	(272,594)
Gross Profit	93,881	117,531
Distribution Expenses	(5,450)	(1,800)
Administration Expenses	(9,450)	(12,900)
Finance Expenses	(18,650)	(9,800)
Net Profit Before Tax	60,331	93,031
Income Tax	(24,800)	(36,800)
Net Profit After Tax	35,531	56,231

The solar panels imported during the last year are no longer in demand, as latest technically advanced panels have entered into the market. The value of these stocks was Rs. 18.26 million and included in the stock as at 31st March 2025. Further, some of invoices relating to sales of solar panels are not available in the company.

You are required to:

- (a) **Identify** three(03) matters that should be considered in preparing the audit plan of **SPS**.
(03 marks)
 - (b) **State** four(04) audit procedures that you need to be performed in auditing the inventory of **SPS**.
(04 marks)
 - (c) **Explain** what is meant by audit sampling.
(03 marks)
- (Total 10 marks)

Question 06

Jayamanna is a director and also the main shareholder of **SJ Lanka Construction (Pvt) Ltd.** which commenced its business activities in 2020. Due to the adverse economic conditions, very few projects were completed by the company during the past few years. There was an accountant in the company and he migrated to Australia in 2024. Newly recruited accountant has prepared the draft financial statements for the year ended 31st March 2025.

Jayamanna has requested your audit firm to conduct the audit of the financial statements for the year ended 31st March 2025.

Audit materiality which was determined based on the Profit Before Tax was Rs.2,500,000/-. Audit team found the following:

- The company did not have any supporting documents relating to a part of the inventory amounting to Rs. 8 million as at 31st March 2025. Further, observation of physical inventory was not conducted to verify the existence of inventory as at 31st March 2025. The auditor was unable to follow alternative audit procedures to verify the inventory also.
- The company has obtained a loan of Rs. 20 million to construct a building on 01st April 2024. The construction of the building was completed on 30th April 2025. Interest on loan for the year amounting to Rs.2,450,000/- has been charged to finance expenses though it should be charged to capital work-in-progress account. The management of the company did not agree to adjust this in the financial statements.

You are required to:

- (a) **Assess** the impact of the above matters on the audit opinion of auditor's report on the financial statements of **SJ Lanka Construction (Pvt) Ltd.** for the year ended 31st March 2025. (06 marks)
- (b) **Explain** the overall objectives of the independent auditor in conducting an audit of financial statements. (04 marks)
- (Total 10 marks)

Question 07

Kumara who is a partner of **WA Associates**, a firm of Chartered Accountants, owns three tourist transport buses. **WA Associates** is the internal auditor of **RF Hotel (Pvt) Ltd.** since 2020. They conduct an internal audit of **RF Hotel (Pvt) Ltd.** in each quarter. The management of **RF Hotel (Pvt) Ltd.** has appointed a new General Manager **Viraj** during the last year. **Kumara** met **Viraj** during the last audit finalization meeting and **Viraj** was very happy about the professional services of **WA Associates**, and he increased the annual internal audit fees by 40% with the approval of the management of **RF Hotel (Pvt) Ltd.**

Once they got to know each other, **Viraj** introduced travel agents to **Kumara** and through these travel agents, **Kumara** received many tourist transport opportunities. Now **Kumara** earns a good profit since all three buses are fully occupied. Further, he is planning to purchase two brand new buses too.

You are required to:

- (a) **Assess** two(02) threats to compliance with fundamental principles of ethics with reference to the above facts. (06 marks)
- (b) **Identify** four(04) safeguards to eliminate or reduce the above identified threats to an acceptable level. (04 marks)
- (Total 10 marks)

End of Section B

SECTION C

(Total 50 marks)

Question 08

Luxmi Garment (Private) Limited (LGPL) is an apparel manufacturing company and 350 employees are working at its factory in Bulathsinhala. The finance team consists of six staff members, with four based at the Maharagama head office and two at the factory. **Rangi** serves as the factory manager, overseeing six supervisors in the factory.

Workers must use the fingerprint machine when entering and leaving the factory. The arrival time of employees is 8:30 a.m. If an employee arrives after 8.30 a.m. but before 9.30 a.m., it will be considered as a short leave. If an employee arrives after 9:30 a.m. but before 12.30 p.m., it will be recorded as a half-day leave.

Finance Executive, **Kamal** downloads a report from the fingerprint software and converts it into an Excel spreadsheet, then he reviews the data at the end of each month. This report indicates the overtime hours based on which overtime payments are calculated. If any discrepancies, such as a missing employee's leaving time, are found, **Kamal** discusses the issues with the supervisors and makes the necessary corrections manually without any approval. Thereafter, he sends the corrected reports to the head office for salary preparation. Additionally, **Kamal** manages the employees' advances and staff loans' records manually and pays advances to employees in cash.

Finance Assistant, **Ajith** is the cashier as well he manages the petty cash float also. Sometimes daily collection on sales is used to make petty cash payments also.

Prior to the introduction of the fingerprint machine, there were several issues with payroll processing, but these problems have been significantly reduced after installation of finger print machine. However, the director, **Asela**, initially believed that the fingerprint system would be completely error-free. But, now he observes that there are certain limitations.

You are required to:

- (a) **Explain** two(02) components of COSO internal control system. (04 marks)
 - (b) (i) **Identify** four(04) internal control weaknesses of **LGPL**. (04 marks)
(ii) **State** a recommendation each to overcome the above weaknesses identified. (04 marks)
 - (c) **Explain** why it is not possible for **LGPL** to have completely error free controls within the organization. (04 marks)
 - (d) **State** three(03) objectives of payroll process. (03 marks)
 - (e) **State** three(03) IT application controls with an example for each. (06 marks)
- (Total 25 marks)

Question 09

You are the Audit Senior of **ABC Associates**, a firm of Chartered Accountants. Your firm has been appointed as the external auditor of **Wish Hospital (Pvt) Ltd. (WHPL)** to conduct the audit of financial statements for the year ended 31st March 2025. **WHPL** is a private hospital specialized in providing maternity care and treating children.

The following information has been noted by you at the initial audit planning meeting:

- Hospital has 120 beds for indoor patients, Out Patient Department (OPD) and Emergency Treatment Unit. The break-down of revenue in the financial statements for the year ended 31st March 2025 are as follows:

Revenue	For the Year ended 31 st March 2025 (Rs. Million)
On Indoor Patients	380
On outpatient Department (OPD), Pharmacy and Other Services	263
Total	643

- The total of Doctor fees and the salaries exceed 20% of the revenue.
- Hospital has an ERP Software and all the transactions are recorded by a well experienced finance team.
- Profit margin of the company has significantly reduced compared to last year.
- The Finance Controller who is well qualified has ensured that the controls relating to financial reporting are in place.
- CEO's bonus was determined based on revenue achievement of the year.
- A loan of Rs.5 million was given to the parent company of **WHPL**.

Your audit firm has hired 20 trainees for this year and the staff partner has asked you to conduct a 5 day orientation program for them during the conduct of the audit of **WHPL**. You noticed that all of them have studied auditing subject but none of them have working experience. As per the staff partner's guidance, you have taken the **WHPL** audit to explain the practical aspects of the planning, execution and reporting of an audit. You have also shared certain information relating to **WHPL** while keeping the audit client's identity anonymous. During the training program, you requested the trainees to go through the specimen working papers you have developed for training purposes with reference to the audit of **WHPL**.

You are required to:

- Identify** four(04) areas that need special attention in performing the audit process at **WHPL**. (04 marks)
- Explain** three(03) matters to be included in the overall audit strategy of **WHPL**. (06 marks)
- State** four(04) areas that auditor shall obtain an understanding of **WHPL** and its environment. (04 marks)
- State** five(05) items to be included in audit working papers of **WHPL**. (05 marks)
- Explain** the following types of audit procedures to be carried out in the audit of **WHPL** with two(02) examples for each:
 - Inspection.
 - Analytical procedures.(06 marks)

(Total 25 marks)

End of Section C

ACTION VERBS CHECK LIST

Level of Competency	Description	Action Verbs	Verb Definitions
Knowledge (1)	Recall Facts and Basic Concepts.	Draw	Produce a picture or diagram.
		Relate	Establish logical or causal connections.
		State	Express details definitely or clearly.
		Identify	Recognize, establish or select after consideration.
		List	Write the connected items.

Level of Competency	Description	Action Verbs	Verb Definitions
Comprehension (2)	Explain & Elucidates Ideas and Information.	Recognize	Show validity or otherwise, using knowledge or contextual experience.
		Interpret	Translate into understandable or familiar terms.
		Describe	Write and communicate the key features.
		Explain	Make a clear description in detail using relevant facts.
		Define	Give the exact nature, scope or meaning.

Level of Competency	Description	Action Verbs	Verb Definitions
Application (3)	Use and Adapt Knowledge in New Situations.	Reconcile	Make consistent / compatible with another.
		Graph	Represent by graphs.
		Assess	Determine the value, nature, ability or quality.
		Solve	Find solutions through calculations and/or explanation.
		Prepare	Make or get ready for a particular purpose.
		Demonstrate	Prove or exhibit with examples.
		Calculate	Ascertain or reckon with mathematical computation.
		Apply	Put to practical use.

Level of Competency	Description	Action Verbs	Verb Definitions
Analysis (4)	Draw Connections Among Ideas and Solve Problems.	Communicate	Share or exchange information.
		Outline	Make a summary of significant features.
		Contrast	Examine to show differences.
		Compare	Examine to discover similarities.
		Discuss	Examine in detail by arguments.
		Differentiate	Constitute a difference that distinguishes something.
		Analyze	Examine in details to find the solution or outcome.