

Corporate Level

Risk, Governance & Audit

Instructions to candidates

- (1) Time allowed: Reading and planning – 15 minutes
Writing – 3 hours
- (2) Total: 100 marks
- (3) This paper consists of two sections.
Section A: 5 questions – **compulsory**
Section B: 3 questions – **answer any 2 questions.**
- (4) Begin each answer on a separate page in the answer booklet. Submit all workings.
- (5) The examination will be conducted as an open book examination and only the following publications will be permitted to be used at the examination hall:
 - Volume I - Sri Lanka Standards on Auditing and Sri Lanka Standards on Quality Management (2024 Edition)
 - Volume II - The SLAuS for Less Complex Entities (LCE) (2024 Edition)
 - Volume III - Sri Lanka Standards on Assurance Engagements, Review Engagements and Sri Lanka Standards on Related Services (2024 Edition)
 - Volume IV - A Framework for Audit Quality and the Sri Lanka Framework for Assurance Engagements (2024 Edition)
 - Open Book Referential - Student Version (Sri Lanka Statement of Recommended Practice, IFRICs and SICs)
 - Code of Best Practice on Corporate Governance 2023
 - A Guide to Corporate Governance in Small and Medium Enterprises 2019
 - Code of Ethics 2023
- (6) Candidates are allowed to bring or use the above permitted publications subject to the following:
 - Highlighting, sidelining and underlining relevant sections in the publications are allowed.
 - **Short notes or any other notes written on the publications are not allowed.** Attaching, pasting, or inserting any other documents to the permitted publications are not allowed.
 - Page tabs to refer the pages are allowed.
- (7) Notes, textbooks (other than permitted publications) or any other materials will not be allowed. Photocopies/extracts of the above publications will not be allowed.
- (8) Answers should be in the **English Language**, in the answer booklet/s given to you.
- (9) Answers written on the answer booklets, graph papers and any other stationery distributed at the examination hall, only, are considered in marking of the answer scripts. Any other attached documents are not taken into account at the time of marking the answer scripts.

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JANUARY
2026

PILOT
PAPER

SECTION A

All questions are compulsory.

Total marks for Section A is 50 marks.

Recommended time for the section is 90 minutes.

Question 01

You are the finance manager of River Green Holdings PLC (RGH), a company listed on the Colombo Stock Exchange and is among the top 100 companies by market capitalization. RGH has several business segments, namely, manufacturing, retail and energy. Per the reporting requirements of the Colombo Stock Exchange, RGH is required to comply with the sustainability-related reporting standards.

The retail segment of RGH plans to launch an online channel to sell its products. The chief executive officer (CEO) has recruited two data engineers to initiate predictive data analysis for the online business. The CEO wants to use predictive data analytics as a mechanism for risk identification, such as competitor behaviour, reduced customer demand, etc.

The CEO needs board papers prepared for the quarterly board meeting to be held. You have been requested to prepare the following board papers.

Board paper 1: Outline methods to manage sustainability-related risks, including environmental impact assessments and mitigation plans.

Board paper 2: Predictive analytics to identify emerging risks, including dashboards and scenario analysis tools.

Required:

- (a) **Outline** four (04) distinct phases that can be adopted as an approach to connect sustainability risks to overall business strategy.

(4 marks)

- (b) **Discuss** three (03) key steps that the management should follow when using predictive data analytics to identify risks in the retail business.

(6 marks)

(Total: 10 marks)

Question 02

Trust Insurance PLC (TIP) is one of the largest life insurance companies in Sri Lanka. TIP has an in-house internal audit department.

The head of internal audit is preparing a paper for the board audit committee (BAC) on the following issues.

1. Management's refusal to provide access to high value claim records to perform an internal audit of the claims settlement process stating, confidentiality and privacy concerns.
2. TIP had launched a new AI-based underwriting system, but the internal audit team does not have IT audit specialists or data-analytics capability.
3. The claims managers perceive internal audit as "fault-finding" and therefore become defensive. The claims managers provide minimal explanations, delay document requests, or avoid discussing control weaknesses.
4. As TIP's business processes are highly automated and transaction volumes are large, the head of internal audit proposes to use suitable data analytics software to perform testing of controls as an initial phase of implementing audit software.

Required:

- (a) **Explain** three (03) limitations and the potential impact on the internal audit function at TIP.
(6 marks)
- (b) **Outline** two (02) benefits of the use of data analytics for controls testing.
(4 marks)

(Total: 10 marks)

Question 03

Shiny PLC (SP) is a renowned gold jeweler in Sri Lanka. As dealers in precious metals and gems, SP is considered a designated non- finance business and has legal obligations to prevent money laundering and terrorist financing under the Prevention of Money Laundering Act (PMLA), No. 5 of 2006; Financial Transactions Reporting Act (FTRA), No. 6 of 2006; Convention on the Suppression of Terrorist Financing Act (CSTFA), No. 25 of 2005.

SP has the following procedures in place in connection with the sale of gold.

- The sales representative meets the customer and discusses the prices of products.
- If the customer is interested in the purchase of any gold items, the sales representative requests the National ID or passport and checks the photograph to confirm the person is the same.
- The customer is provided the invoice and is requested to make the payment at the cashier. The cashier accepts credit cards or cash as payment and stamps all copies of the invoice as paid and keep one copy on file. Some customers pay cash in excess of Rs. 5 million.
- One copy of the invoice is stamped “acknowledged good” and signed by the customer and retained by the sales representative. The original of the invoice is given to the customer together with the gold items purchased.
- The daily sales report is prepared and sent to the finance division for cash to be banked.
- Daily sales are posted in the general ledger. No further records are kept on sales, including a customer details database.

Required:

- (a) **Analyse** the deficiencies in the process described above when complying with laws given in the scenario.

(6 marks)

The chief internal auditor wishes to review Corporate Governance of SP in the next audit cycle. The areas to be covered include the board audit committee’s oversight over external auditors.

Required:

- (b) **State** four (04) responsibilities of the board audit committee in connection with the external auditors.

(4 marks)

(Total: 10 marks)

Question 04

HiFashion Ltd (HFL) is a garment manufacturing company. The external audit of HFL is in progress, and you have been requested to supervise the fixed assets count. During the physical verification of fixed assets, your team noted that several high-value machines listed in the fixed asset register are not present on the factory floor. When questioned, the finance manager explained that the machines were “temporarily moved to a subcontractor’s premises,” but no documentation, such as transfer notes, subcontractor agreements, or movement logs/gate passes, is available to support this claim.

You were concerned about the fixed asset values recorded in the financial statements and informed the audit partner. When the audit partner met the chief executive officer, he had implied that raising issues could “jeopardize the business relationship” and the audit team should finalise the audit without further delay if the firm wants to retain the audit.

Required:

- (a) Considering the professional ethics and independence, **discuss** the independence threat and the steps the audit team should follow to address the above scenario.

(5 marks)

HFL exports high-end denim garments exclusively to two European buyers. Buyers have requested an assurance report over the sustainability report of HFL. As per the agreement with the buyers, amongst other requirements, HFL should:

- Use solar energy for 50% of its power consumption
- Recycle water used in the washing plant for 3 washing cycles and
- Treat wastewater before releasing it to the environment.

The ratio analysis done by the auditor on energy units used indicates that only 45% of energy was generated by solar power. In the sustainability report, HFL claims that they have fulfilled all ESG requirements of the foreign buyers. The audit partner believes that non-compliance with 50% solar energy is not a significant matter and agrees with the compliance report.

Required:

- (b) Based on the above scenario:
- (i) **Examine** the risk relating to ESG reporting.
 - (ii) **Explain** the threat to the independence of the auditor.

(5 marks)

(Total: 10 marks)

Question 05

The Sri Lanka Tea Board (SLTB) is the regulator for the tea exporters. It has recently requested a tea exporter to submit a report comprising the value of tea exported to the USA for the year 2025 to compute the tariff impact.

In addition, the report should include a reconciliation of the trade receivables balance from USA customers from 1 January 2025 to 31 December 2025 considering sales and cash received from USA customers as well as the exchange losses/gains from exports to the USA.

SLTB also requires the export values to be certified by the external auditors to verify that the exports match with the shipping documents and confirm the debtor's reconciliation and exchange losses/gains.

You are the audit manager of Good Tea (Pvt) Ltd (GTL), and you have finalised the audit of the financial statements for the year ended 31 December 2025. The finance manager of GTL, Saman, called you to check how a report can be obtained from the auditor to meet the requirements of SLTB. You have proposed to perform an agreed-upon procedures engagement.

Saman explained that the exchange rate fluctuations can be attributed to the following.

1. USA customers receive a credit period of 30 days.
2. GTL accrues commission payable to USA brokers in USD and settles them in USD.
3. The Rupee had strengthened against the USD and therefore Sri Lankan tea has become expensive compared to other tea.

Required:

- (a) **Explain** two (02) steps an auditor should perform when establishing the terms and the scope of an agreed-upon procedures engagement. (4 marks)

- (b) **Analyse** three (03) forms of foreign currency risks in the above scenario. (6 marks)

(Total: 10 marks)

SECTION B

Two out of the three questions should be answered.

Total marks for Section B is 50 marks.

Recommended time for the section is 90 minutes.

Question 06

WoodCraft Ltd (WCL) is a furniture manufacturing company that had a reputation for quality products. It is a family-owned business. It manufactures and sells household furniture through a network of retail stores as well as undertakes large contracts for the manufacture and supply of furniture for hotels and development projects. WCL operates a single manufacturing plant and maintains a warehouse for finished goods.

WCL offers custom-made products for the large development projects where revenue recognition is different from the regular products, as one of the pieces of furniture is installed at project sites. Per the management accounts for the financial year ended 31 December 2025, revenue from special projects had increased 35% compared to the year ended 31 December 2024.

WCL's sales order book had not seen any increase during the past three years due to economic conditions in the country. Therefore, there had been no growth in revenue. However, management plans to invest in new machinery, increase production, and undertake business development to increase revenue. For this purpose, they are seeking external financing in the next twelve months by way of bank loans. Considering the collateral for the bank loan, the land and buildings had been revalued and recorded in the financial statements for the year ended 31 December 2025.

The main raw material is timber, and WCL sources timber from multiple local suppliers. The timber prices have been volatile, often increasing due to supply shortages. The production involves multiple stages (cutting, assembly and finishing) and the work in progress (WIP) valuation is complex as it involves different types of timber and different stages of finishing with different skilled labour.

WCL implemented a new accounting system in October 2025, two months before the financial year ended 31 December 2025. Implementation was done in-house by a finance executive.

There is a high volume of manual journal entries for the year ended 31 December 2025 due to the new accounting system not being fully integrated with the general ledger. During 2025, WCL had recruited a qualified finance manager. Previously, one of the owners of WCL oversaw the finance function. It was noted that segregation of duties is limited due to a small accounting team.

You gathered the above information during the initial meeting with the finance manager to plan the audit of the financial statements for the year ended 31 December 2025. You are an audit manager at Sydney & Co., and your firm has been engaged to perform the financial statements audit of WCL for the year ended 31 December 2025. This is the first-year Sydney & Co. auditing WCL.

The management letter for the previous financial year audit revealed that a timber cutting machine with a carrying value of Rs. 3.5 million was not available during the physical verification of property, plant & equipment, and the issue was unresolved. Adjustment in previous years financial statements was not made since the management agreed to locate the machine and rectify the issue during the year 2025. This value is above the performance materiality level for the current year.

You met the audit partner who requested you to prepare an “overall audit strategy.”

Required:

- (a) **Outline** what an overall audit strategy is and its purpose. (2 marks)
- (b) As you plan the overall audit strategy, **discuss** the following.
(i) A matter that you would consider in planning the audit.
(ii) Four (04) matters that would increase the risk of material misstatement.
(iii) Two (02) staffing considerations to address matters noted in the above scenario.
(iv) A consideration for timing of the audit. (10 marks)
- (c) **Prepare** audit programs consisting of two (02) audit procedures for revenue and purchases each to be performed at the interim level and final level to address the risks indicated in the above scenario. (8 marks)
- (d) **Analyse** the impact of the prior year management letter points on the audit opinion for the year ended 31 December 2025. (5 marks)

(Total: 25 marks)

Question 07

Rekzo Pharma PLC (Rekzo) is in the business of importing and distributing medicine and medical devices in Sri Lanka. A few products are manufactured in Sri Lanka at a factory in Ekala. Rekzo had been operating in the pharmaceutical industry for approximately fifty years and is therefore at a very mature stage. However, there had been a decline in revenue and profits in the recent past. Rekzo is listed on the Colombo Stock Exchange and has more than 80% of institutional and public shareholders. The promoter family only owns 5% of the ordinary shares.

You are the audit manager of Rekzo for the financial year ended 31 December 2025, and the audit partner informed you that there were unadjusted audit differences above the performance materiality level last year. Further, some of the critical controls, such as IT general controls, had been identified as not reliable during last year's audit.

Further, during the year 2025, Rekzo bid for a large government tender that could result in significant profits in the next three years. However, it was recently confirmed that the tender was awarded to a competitive company for the next three years, and Rekzo has forecasted net losses for the next three years. You have noted that the board of directors had approved the business plan with losses forecasted for the next 3 years. The audit partner believes that this is an indicator of going concern.

Key financial information for the financial year ended 31 December 2025 per the draft financial statements are as follows.

	Amount (Rs.million)
Revenue	650.13
Profit before tax	85.3
Profit after tax	59.9
Total equity	114.24
Total assets	800.93

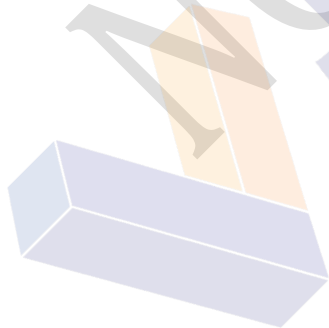
On 31 December 2025, Rekzo had a stock of imported eye lenses amounting to Rs. 10.3 million, which will be expiring on 3 April 2026. Rekzo had not made impairment provision for these stocks even though they will be expiring after the year-end. Rekzo has managed to sell some of these lenses after 31 December 2025 before the expiry date. The value of the sales of those lenses amounted to Rs. 1.1 million.

The chief financial officer has requested a draft audit opinion to consider what the impact would be if the above adjustment in connection with the eye lenses stock is not made in the financial statements for the year ended 31 December 2025.

Required:

- (a) Considering the scenario above, **calculate** the overall and performance materiality for the audit of financial statements for the year ended 31 December 2025 and support the basis for the benchmark and thresholds used. (7 marks)
- (b) Considering that the expiry of eye lenses stock after the balance sheet date is an event after the reporting period,
- (i) **Outline** three (03) audit procedures that can be performed to test the event after the reporting period.
 - (ii) Based on the scenario above, **explain** the appropriate audit conclusion on the eye lenses stock balance expiring after 31 December 2025. (9 marks)
- (c) **Outline** four (04) audit procedures to test whether the going concern assumption is appropriate when preparing financial statements. (4 marks)
- (d) Assuming that the management is not in agreement with your conclusion on expiring eye lenses, **discuss** your conclusion to be communicated to the chief financial officer. (5 marks)

(Total: 25 marks)



Question 08

MetroMart Retail Ltd (MMR) is a large supermarket chain operating 42 stores across the country. MMR leases most of its retail outlets and distribution warehouses. MMR recognises Right-of-Use (ROU) assets and corresponding lease liabilities for these properties under SLFRS 16 - *Leases*.

For the year ended 31 December 2025, the draft financial statements showed the following account balances:

- ROU assets (net carrying amount): Rs. 1.85 billion
- Lease liabilities: Rs. 2.10 billion
- Employee benefits expense: Rs. 620 million
- Retirement gratuity provision: Rs. 145 million

Additional information:

ROU assets

MMR has 78 lease contracts, including stores, warehouses, and office space. Five of these leases are for a period less than twelve months and three leases are identified as small value leases. Accordingly, MMR has not recognised ROU assets for these three lease contracts.

During the year, twelve new stores were opened and four stores were relocated. There are five locations in Colombo that have high values, representing 20% of the ROU asset.

MMR uses a centralised lease management system to calculate ROU assets, discount rates, and lease terms. Therefore, the auditor has to obtain a list of ROU asset balances provided by the management to select a sample to ensure completeness, accuracy and valuation of the ROU asset.

Retirement gratuity

MMR employs over 350 staff, many of whom have long service periods. The retirement gratuity provision is calculated by an external actuary using assumptions for salary growth, staff turnover, and discount rates. A five-year fixed deposit rate has been used as the discount rate since such rates are reliable.

Management made manual adjustments to the data of 37 employees due to the "corrections" in HR records. HR records show inconsistencies in employee start dates and salary histories at two regional branches.

After performing the audit procedures, the auditor has determined that the amount of manual adjustment is inappropriate and the misstatement is above the materiality level.

Required:

- (a) **Determine** an appropriate sampling approach to test the accuracy and completeness of ROU asset calculations, including factors that influence sample size. (4 marks)
- (b) (i) **Outline** the sampling risk that can exist relating to the sample selected to perform substantive procedures. (2 marks)
- (ii) **Analyse** the appropriateness of the population used for sampling. (4 marks)
- (iii) In addition to the sample testing of lease contracts in the centralised lease system, **analyse** two (02) audit procedures to ensure existence of ROU asset. (3 marks)
- (c) **Explain** two (02) audit procedures with detailed steps to test the appropriateness of manual adjustments to retirement benefit valuation. (4 marks)
- (d) **Discuss** the appropriateness of using five-year fixed deposit rate as the discount rate for calculation of retirement gratuity provision when performing audit procedures. (3 marks)
- (e) **Prepare** the audit opinion and basis for audit opinion paragraphs to address this material misstatement. (5 marks)

(Total: 25 marks)