



UNIVERSITY OF KELANIYA – SRI LANKA
Centre for Distance and Continuing Education
Faculty of Commerce & Management Studies

Bachelor of Commerce (Special) Degree Third Year Examination (External) – 2023

November – 2025

BCOM E 3072 - Auditing & Assurance Service

No. of Questions : Five (05)

Time: 03 hours

Answer Four (04) Questions including Question 01 (Compulsory)

Question No.01

You are the audit manager of **KNS & Co.**, a firm of Chartered Accountants. **AgriWell Naturals (Pvt.) Ltd. (AgriWell)** operates in the organic food production and distribution sector and has experienced significant growth over the past few years. The company prepares its financial statements in accordance with Sri Lanka Accounting Standards (LKAS/SLFRS).

Today is 10th December 2025, and KNS & Co. has been invited to audit the financial statements of AgriWell for the year ending 31st December 2025, for the second consecutive year.

Recently, AgriWell was acquired by a global food and agriculture corporation, leading to a complete change in the board of directors and key management personnel, as well as a restructuring of the internal control systems. The new board aims to present the audited financial statements to overseas stakeholders by early February 2026 and has requested KNS & Co. to start the audit immediately and complete it within a tight timeframe.

Due to multiple ongoing engagements during the December–January period, KNS & Co. is planning to assign a less experienced audit team to the AgriWell audit. Additionally, Ms. Senanayake, who is married to the audit partner Mr. Gunawardena's cousin, was recently appointed as the Chief Financial Officer (CFO) of AgriWell. Earlier this year, KNS & Co. also provided valuation advisory services for the AgriWell brand, which is now capitalised in the financial statements.

Required:

- (a) This is the second year KNS & Co. has been auditing AgriWell. Your firm is now considering whether to update the terms of the engagement or issue a reminder of the existing terms. **Identify** the key factors that should be taken into account in making this decision.

(05 Marks)

- (b) **Discuss** the significance of auditing financial statements for a company. **Explain** why auditors provide reasonable assurance rather than absolute assurance in a financial statement audit.

(10 Marks)

- (c) **Outline** the ethical and professional considerations that should be evaluated before continuing the audit engagement with AgriWell, in line with the Code of Ethics issued by the Institute of Chartered Accountants of Sri Lanka.

(10 Marks)

(Total 25 Marks)

Question No. 02

Bio In One (Private) Limited ("BIO") is engaged in the production of powdered coconut milk for the domestic market. The company was established six (06) years ago and the initial operations were carried out on a small scale. The company has now expanded to more than 50 wholesale customers including direct distributors and agents in supermarkets. The company's manufacturing plant employs 120 employees. However, the main business activities as per the formal regulations are not owned by BIO.

Ms. Nilani, the wife of the Managing Director of the company, is involved in the invoicing and follow-up of the dues collection process. However, she has no background in accounting or finance.

The Managing Director has requested your professional accounting firm to assess the internal control of the company. The partner of your accounting firm has given the following information:

- The company has not prepared financial statements for the past 3 years.

- The company does not maintain proper records of material purchases and supporting documents related to payments. The managing director, who is the major shareholder of the business, is personally involved in purchasing raw materials and other supplies.
- During the discussion with the client, the partner in charge of this task has explained to the managing director the importance of maintaining proper records and having a proper internal control system for the company. The managing director needs the assistance of your accounting firm to set up an internal control system for the company. It has also been decided to establish a computerized system with trained staff.
- As a first step, the Managing Director has requested the Project Manager to present the proposed internal control system for BIO Company to the Managing Director, Ms. Nilani and two other managers at an awareness workshop. Since BIO Company is going to use a computerized system, the relevant partner has also been requested to provide an explanation of the general controls and application controls related to information technology.

You are required to:

(a) Explain how the following controls are relevant to an appropriate internal control system for BIO Company, with an example:

- Operational controls.
- Financial controls.
- Compliance controls (10 marks)

(b) Identify three (03) internal control weaknesses in BIO Company. Analyze the internal controls required to correct them

(05 marks)

(c) Explain the need of COSO components to develop an internal control system

(10 marks)

Question 03.

You are the senior in-charge of the audit of XYZ Holdings Ltd. for the year ended March 31, 2025. The group comprises five local subsidiaries and a joint venture. One of the local subsidiaries was acquired during the year. Entities within the group operate in a diverse range of business activities, including manufacturing of electronics, hospitality, construction, financial services, and IT solutions.

During the initial team discussion, the engagement partner, Mr. Sharma, emphasized that the audit team should focus on revenue recognition and ensure that sufficient and appropriate audit evidence is gathered. There has also been recent adverse media publicity regarding allegations of the Group Finance Director, Ms. Kapoor, misusing company assets.

Required:

- (i) **Discuss** what is meant by sufficiency and appropriateness of audit evidence and list four (4) factors that influence the reliability of audit evidence.

(10 Marks)

- (ii) **Discuss** the relationship between the risk of material misstatement and the sufficiency & appropriateness of audit evidence.

(05 Marks)

- (iii) **Explain** the auditor's responsibility with reference to the prevention and detection of frauds according to SLAuS 240. **Identify and explain** four (04) audit procedures that the audit engagement team of XYZ Holdings Ltd. can perform regarding revenue recognition.

(10 Marks)

(Total 25 Marks)

Question No. 04

- (a) **Explain** the purpose and importance of including a Key Audit Matter (KAM) paragraph in the auditor's report. In your answer, **discuss** the benefits to users of financial statements and outline the key considerations auditors apply in identifying which matters should be reported as KAMs.

(05 Marks)

- (b) You are the audit supervisor at Vision Audit Associates, a firm of Chartered Accountants. You are planning the audit of your client, Nova Chemicals (Pvt.) Ltd. (Nova), a manufacturer of industrial cleaning agents. The company's financial year ended on 31st December 2025, and the draft profit before tax is Rs. 36 million. This is your first assignment leading a large audit team, and you are expected to oversee and review the work done by junior audit staff.

During the year, Nova faced supply delays for raw chemical inputs sourced from Europe, due to logistics disruptions. Delivery times extended from the usual 3 weeks to over 7 weeks toward the end of the year. The company invested Rs. 4 million in developing a new

biodegradable product line, expected to be commercially released in August 2025. Nova also purchased Rs. 1.8 million worth of customized laboratory equipment during 2024, with all associated costs, including modification charges and financing interest, capitalized in the books.

In August 2025, Nova introduced a cloud-based accounting software to streamline its reporting. The implementation phase extended until February 2026, with both systems operating in parallel. The finance manager confirmed that some reconciliations, such as inventory and trade payables, were pending as of year-end due to the added workload. Compounding the issue, two senior finance officers resigned in December 2025 citing job stress and increased overtime.

Required:

Identify four audit risks, and for each risk, **explain** the auditor's appropriate response to mitigate it during the planning phase of the audit of Nova Chemicals.

(10 Marks)

(c) Veta Ltd. (Veta) manufactures women's clothing and its year-end was 31st March 2025.

You are an audit supervisor of PQR & Co., a firm of Chartered Accountants, and the year-end audit for Veta is due to commence shortly.

The draft financial statements recognize profit before tax of Rs. 2.6m and total assets of Rs.18m.

At the planning meeting, the finance director of Veta informed the audit engagement partner that the company was closing one of its smaller production sites and as a result, a number of employees would be made redundant. A redundancy provision of Rs.110,000 is included in the draft financial statements.

A few months have now passed and the audit team is performing the audit fieldwork including the audit procedures which you recommended over the redundancy provision. The team has calculated that the necessary provision should amount to Rs.305,000. The finance director is not willing to adjust the draft financial statements.

You are required to;

Discuss the issue and its impact on the auditor's report, if any, should this issue remain unresolved.

(10 Marks)

(Total: 25 Marks)

Question No 05

Briefly Explain Following Terms

- a. Professional Skepticism
- b. Materiality
- c. Professional Judgement
- d. Qualified Opinion
- e. Financial Statement Assertions.

(05 Marks x 05 =Total 25 Marks)