

## Examiner's Report

### AA3 EXAMINATION - JANUARY 2016

### **(AA34) PROCESSES, CONTROLS AND AUDIT**

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#### **General Comments**

Candidates' performance for this paper was average. Majority of candidates scored low marks for this paper for practical aspects. It was noted that most of the candidates have not gone through the syllabus and practiced past papers. It is extremely important that candidates need to know that exam paper is prepared within the scope of the syllabus and candidates who studies the syllabus properly can get through this paper without much difficulty.

Action verb Check List with definitions is attached to the question paper itself and 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. Nevertheless it could be noticed that the candidates do not pay adequate attention to what is expected from the action verb. It is extremely important to have a good knowledge about the action verbs. E.g.: When the examiner asks to "state" it is expected to express something definitely or clearly and it is not required providing lengthy explanations. When candidates are trying to give unnecessary detailed explanations it will waste their time and they will not be able to score marks for other questions because of the time limitation.

#### **Section A**

Four (04) Compulsory Questions

#### **Question No. 01**

##### **Part (a)**

This question required to list three (3) fundamental principles as set out in the code of ethics for Professional Accountants. Most of the candidates have correctly listed the fundamental principles and obtained full marks allocated to this part of the question. However, some candidates have not understood the meaning of the word **list** and have given lengthy explanations wasting their valuable time.

##### **Part (b)**

This question required to state 2 types of threats which may affect the compliance with the fundamental principles. Many candidates have stated the threats correctly and hence, obtained full marks allotted for this part.

However, some candidates have misunderstood the question and given irrelevant answers such as internal risk and external risk, risk in operations, fraud risk, political and legal risk, social and cultural risk, scope limitation, disagreement with the management, threats occurred due to non-compliance with code of ethics, threats occurred due to non-compliance with Accounting & Auditing Standards, lack of correct information and negligence etc.

**Question No. 02** (Marks Allocated 05)

**Part (a)**

In this part of the question candidates are required to explain the importance of “assurance” to the users of financial statements. Majority of the candidates have correctly explained the importance of “assurance” and obtained full marks allotted for this part.

**Part (b)**

In this part of the question candidates are required to identify three (03) examples for Assurance Engagements, a practitioner may perform other than a statutory audit.

Majority of the candidates have identified either one or two examples correctly and obtained marks accordingly. Only a few candidates obtained full marks allotted for this part. Internal audit, external audit, financial audit and value for money audit are some of the common incorrect answers produced by the candidates.

**Question No. 03** (Marks Allocated 05)

**Part (a)**

In this part of the question candidates are required to state two (02) instances in which management representations are necessary.

Many candidates have written at least one instance in which management representations are necessary and obtained 01 mark out of 02 Marks allotted. However some candidates have obtained no marks as they written wrong/ irrelevant answers.

**Part (b)**

This question required candidates to explain the instructions to be given to an Audit Junior when none or few responses have been received from debtors after calling confirmations from a large sample.

Only a few candidates were able to obtained total marks allotted for this part. Many candidates obtained either low marks or no marks as they have written incorrect/ irrelevant answers such as, withdrawal from the audit engagement, modify the audit report, obtain management written representation, take legal action against debtors who failed to respond for the confirmation called and not to make any credit sales etc.

**Question No. 04** (Marks Allocates 05)

**Part (a)**

This question required candidates to state two tests of controls that may perform in evaluating the operating effectiveness of internal controls relating to revenue of KM supermarket (Pvt.) Ltd. Only a few candidates have correctly answered and obtained total marks allotted for this part.

Some of the irrelevant answers written by the candidates are as follows:

- Use professional skepticism.
- Prepare audit working papers.
- Inspection of inventories.
- Financial controls, accounting controls, general controls and application controls.
- Quality control procedures.

### **Part (b)**

This question required candidates to state three substantive procedures to vouch the accuracy of revenue. A handful of candidates correctly answered this and majority of the candidates have produced following irrelevant/ incomplete answers:

- Inspect previous year audit report.
- Observe last year engagement letter.
- Physical inspection.
- Check whether opening balance of revenue has been C/Fd correctly from previous year.
- Identify control environment, identify risks, control activities and monitoring.
- Procedures relating to inventory management.  
Eg: - Every issue should be supported by an authorized MR note, Maintain Inventory coding system, Inventory counts and Physical safe guards (CCTV cameras) etc.

### **Common findings relating to the given answers for Part (a) and (b):**

- Most of the candidates have not understood the fact that this question is relates to revenue of a supermarket
- Also some candidates have mentioned substantive procedures to vouch inventory, fixed assets etc, instead for revenue.
- Rather than audit procedures ( test of controls and substantive procedures) candidates have written controls implement by management
- Most of the candidates have written components of Internal controls, techniques used in mitigating risk and categories of internal controls
- Most of the candidates have just written as observation, inspection, inquiry etc
- Overall understanding of audit procedures is at a very lower level

## **Section B**

### Three (03) Compulsory Questions

#### **Question No. 05** (Marks Allocated 10)

##### **Part (a)**

This question required candidates to list three matters to be included in the audit planning memorandum. It was noted that most of the candidates had not identified the exact point/matter correctly, instead they have identified one or two components included in a particular matter. For an example, instead of identifying 'Overall Audit Strategy' as a point, some candidates have considered 'nature', 'timing' and 'extent' as three points. That type of answers was able to obtain only a mark as Overall Audit Strategy comprised of all those three points.

Majority of the candidates had misunderstood the question and had mentioned 'matters to be included in the letter of engagement' as the answer.

##### **Part (b)**

In this part of the question, it was required to list three sources of information that an auditor may use to obtain an understanding of the entity and its' environment. Most of the candidates have incorrectly identified debtor's confirmations, stock sheets, and reclassification; re-perform etc.as correct answers for this question. Further some had explained the areas of business an auditor need understanding instead of the sources such as nature of the entity, industry, etc.

##### **Part (c)**

It was required from this question to explain two possible responses of the audit supervisor for the above identified audit risk. This question had been very poorly answered by majority of the candidates. Some candidates without any idea of the question have mentioned that auditor needs to terminate this assignment due to the identified risk. It was further noted that most of the candidates have not attempted this question.

#### **Question No. 06** (Marks Allocated 10)

##### **Part (a)**

It was required from this question to state the three steps of Risk Management Framework. However, a few candidates have misunderstood the concepts and given irrelevant answers such as avoid risk, prevention and minimizing audit risk, design audit procedures to address the material risk, checking the responsibilities of management and auditors etc.

Further, it was noted that even the candidates who scored full marks for this part had wasted their time to write lengthy paragraphs with unwanted descriptions.

### **Part (b)**

This question required candidates to state two reasons to prove the importance of performing regular physical inventory verification. On the whole, majority got full marks for this part. However, there were irrelevant answers such as reduction in maintenance cost, to identify deficiencies in internal controls, to calculate net profit/ gross profit, to minimize holding cost etc.

### **Part (c)**

In this part of the question, the examiner has tested as to how to obtain audit evidence for the given account balances under each of the assertion mentioned therein.

On the whole, answers were not satisfactory. It was noted from the answers that considerable number of candidates have mentioned the audit tests/procedures that need to be performed under each of the given account balances without addressing the requested assertion and as a result they have wasted their time.

### **Question No. 07** (Marks Allocated 10)

#### **Part (a)**

It was required from this question to state three inherent limitations of internal controls. Most of the candidates have correctly stated the inherent limitations of internal controls and obtained the full marks allotted to this part. However, some candidates have given irrelevant answers such as risk of fraud, unusual transaction, significant transaction with a related party, management intervention, complex accounting principles, manual intervention etc, as the answer for this part. Further, few of them had mentioned internal control weaknesses in the given scenario as the answer.

#### **Part (b)**

This question required candidates to identify a preventive control and a detective control operating in the company given in the question. Only a handful of candidates were able to score full marks for this part. Some candidates have mentioned the categories of internal controls, i.e, operational, compliance, preventive and detective as the answer. However, similar question has been tested in the previous Examination as well. Poor performances may be due to not practicing the past question papers and not studying the contents of the subject properly.

#### **Part (c)**

This question required candidates to identify two internal control weaknesses in the given scenario. Many candidates have identified correctly the internal control weaknesses in the explained company and obtained full marks. However, some candidates could not identified those correctly, and mentioned various irrelevant answers such as purchases are made centrally, ordered goods are directly delivered to the outlets, sales targets have not been achieved, not maintaining a buffer stock, not using inventory control techniques such as EOQ, ERP etc.

### **Part (d)**

This question required candidates to explain how the management would overcome each of those weaknesses identified in the above question. This question has also been very satisfactorily answered by majority. However, those candidates who could not identify the internal control weaknesses correctly have not identified the recommendations as well.

## **Section C**

Answer any two (02) questions only

**Question No. 08** (Marks allocated 25)

### **Part (a)**

This question required candidates to explain policies and procedures that need to be considered for quality control on individual engagements. A fewer number of candidates have given the correct answer and have obtained satisfactory marks for this section. Whereas another set of candidates have given highly incorrect/irrelevant answers. There were candidates without understanding the requirement of the question properly, has mentioned the quality control policies and procedures relating to a production process. Considerable number of candidates has mentioned incorrect answers such as inspection, observation, computation, re-calculation, time management etc.

### **Part (b)**

- (i) This question required candidates to identify four areas that need special attention in performing audit procedures to audit the accounts receivable balance. Considerable number of candidates has identified special areas with referring to the given Age Analysis correctly. However, there were candidates who could not identified special areas correctly and have mentioned time given for settlements, management of finance and purchase procedure etc.
- (ii) This question required candidates to state reasons for considering those areas identified in (i) above, as important when performing audit procedures to audit accounts receivables. It was noted that those who could not identified the correct answers for (i) above, have not mentioned any answer to this part. Further, even the candidates who have given correct answers to the above part, have not attempted this part.
- (iii) It was required from this question to explain two matters to be considered when selecting a sample of accounts receivables from the given listing to apply audit procedures. Almost all the candidates have attempted this part. However, majority of them have written answers with regards to selection of a common sample, not a sample from the accounts receivable balance. Some of the incorrect answers given are statistical, non-statistical, arrears amount of the age analysis, random selection etc.
- (iv) It was required from this question to state two actions that may take as the auditor in response to the General Manager's behavior. Though, almost all the candidates had attempted this question, only a handful of candidates were able to obtain the full marks allocated to this part. Some of the incorrect/irrelevant answers given are taking legal actions against the GM, calling confirmations with a legal approval, express a qualified opinion in the audit report, terminate the audit assignment, request again from the GM, calling positive conformations etc.

### **Part (c)**

It was required from this question to identify any five weaknesses noted in the working paper provided. Majority of the candidates have attempted this and obtained satisfactory marks. There were few candidates instead of identifying mistakes, have introduced with a new format to present the working paper. Some others have given incorrect/irrelevant answers such as unavailability of the date of review, the name of the reviewer, profit/loss, structure of the organization, address of the auditor, number of workers and insufficient sample has been taken etc.

### **Question No. 09** (Marks Allocated 25)

#### **Part (a)**

- (i) It was required from this question to explain the three types of modified audit opinions. As a whole, the performance for this part was at a fairly satisfactory level. Many candidates have pointed out the three types of audit opinion and earned 3 out of 6 marks. Even though most of the candidates have stated the types of modified audit opinion, they were unable to explain those in order to gain full marks allocated. It was noted from the answers that some candidates were totally new to this area of the question.
- (ii) In this part of the question, examiner tested the knowledge of the candidates regarding the audit report. Only a very few candidates had earned full marks for this part and considerable number of candidates have earned around 4 to 6 marks for this part. However some candidates have produced irrelevant answers such as not mention the audit procedures performed, not mention about the audit evidences obtained, not mention about the client's name, nature of the client's business, not mention the scope of the auditor, not mention the objectives of the audit and not mention the responsibility of the auditor.

#### **Part (b)**

- (i) This question required candidates to state two benefits of preparing a bank reconciliation statement to an entity. Almost all the candidates have attempted this part. For this part, around 50% of the candidates have earned full marks. Others earned ½ marks because the only benefit that they had mentioned is "Reasons for the differences between bank book balance and bank statement balance can be identified".
- (ii) This question required candidates to identify four areas that need special attention in the given bank reconciliation statement. For this part, around 75 % of the candidates had earned full marks and others had earned around 2 or 3 marks. They had mentioned some generalize answers instead of identifying specific answers. Balance as per cash book, unrealized deposits, unpresented cheques, dates and cheque numbers are some of the irrelevant answers given by candidates.

- (iii) This part of the question required candidates to state the reasons for selecting those areas in (ii) above as areas which require special attention. Most of the candidates, who earned full marks for part (ii) above, were able to obtain full marks for this question as well. But those candidates, who had not attempted the above question, had not attempted this part as well. Failing to answer a practical question of this nature shows the inadequate practical experience that candidates possess.

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**Common points to consider for improving of the competency level:**

- (1) Thorough study of the entire syllabus.
- (2) Candidates should read the question carefully a several times and should not write unnecessary explanations and details, when a direct and accurate answer is expected from the question.
- (3) Refer study text, books, articles, magazines in relation to this subject and other reading materials related to Auditing.
- (4) Action verb Check List with definitions is attached to the question paper itself and 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
- (5) It is important to present the theoretical concepts in an organized manner and quote examples wherever necessary, when writing an answer.
- (6) Make sure that the handwriting is legible and have numbered the answers, appropriately.
- (7) Follow the instructions given in the exam paper.
- (8) Study the past papers and answer to improve your knowledge.
- (9) Effective time management.
- (10) Check twice whether answers are numbered properly before submitting the answer scripts.
- (11) Face the exam with a good preparation and with the utmost hope of passing the exam.

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