

Examiner's Report

AA3 EXAMINATION - JULY 2016

(AA34) PROCESSES, CONTROLS AND AUDIT

General Comments

Students' performance for this paper was at an average level. Majority of students have not understood the questions before start writing the answers. Practice to answering past question papers is a good solution for this. Most of the theory questions could have been correctly answered by an average student if they have read and properly understood the subject matters contained in the study text.

Section A

Four (04) Compulsory Questions

Question No. 01 (Marks Allocated 05)

This question required candidates to explain the principle of "Integrity" as set out in the Code of Ethics for Professional Accountants and to state two types of assurance engagements an auditor can perform.

This was a very straight forward question where a direct answer could have been given. However, without writing direct answer, students have given irrelevant answers such as professional accountants should not involve in fraudulent activities, professional accountant should not be biased, should not provide organizational information to third parties etc. Most students have mentioned that professional accountant should be honest which was an irrelevant answer. However, considerable number of candidates has given the correct answer.

Instead of writing types of Assurance Engagements considerable number of students has given irrelevant answers such as types of audit opinions.

Performance for this question was not that satisfactory.

Question No. 02 (Marks Allocated 05)

Part (A) of this question required candidates to explain what "Agency Conflict" is. Some students have mistakenly identified the Agency Conflict as a conflict between the auditor and the management and they have mentioned it as a struggle between the management to get the control of the company etc.

Part (B) of the question required to state two guidelines for Board of Directors that have been highlighted by the Code of Best Practice on Corporate Governance. This question was very poorly answered by majority of the candidates. They have given wrong answers such as implementation of the proper internal controls, preparation of accounts on time etc.

Performance for this question was not that satisfactory.

Question No. 03 (Marks Allocated 05)

Part (A) of the question required candidates to state three elements of a system of quality control in an audit firm. However, there were some students who have given incorrect answers such as direction, supervision and review etc.

Part (B) of the question required candidates to explain an audit procedure to verify existence of Property, Plant and Equipment. For this question also irrelevant answers such as recalculate the depreciation charges, use expert service etc, have been given.

However, most of the students have given correct answers for this question and were able to obtain three (3) or more marks out of the five marks allocated.

Performance for this question was at a satisfactory level.

Question No. 04 (Marks Allocates 05)

Part (A) of the question required candidates to state four instances in which the auditor may use external confirmations and Part (B) required candidates to identify a factor that might indicate doubts about the reliability of the response to an external confirmation request sent by the auditor.

Some students have mentioned list of documents such as bank statements, stock certificates, cash certificates etc., for part (A) instead of instances. Most of the students have not answered the part (b) and some students have given irrelevant answers such as when the third party refused to reply, when the client has stop maintaining relationship with the third parties etc.

Performance for this question was not at a satisfactory level.

Section B

Three (03) Compulsory Questions

Question No. 05 (Marks Allocated 10)

Part (A) of this question required candidates to explain the impact on the financial statements when a fixed asset item has not been capitalized on time. Further, part (B) required to explain what the emphasis of matter paragraph” and part (C) tested the important matters stated in the introductory paragraph of an auditor’s report.

Majority of the students have correctly identified the impact on the auditor’s report correctly and were able to obtain the full marks allotted. However, for parts (C) there were some matters included in the auditor’s report which do not belong to the introductory paragraph.

Overall, performance for this question is satisfactory.

Question No. 06 (Marks Allocated 10)

From this question, the examiner has tested the theory knowledge of candidates regarding the current Audit file, ways of understanding about the company, its industry and environment and the financial statement assertions.

Although it has been a very popular question in many previous examinations, some students still found it difficult to provide correct answers for part (A). Some candidates have mentioned documents that are to be included in the permanent audit file. Further a fewer number of candidates have given irrelevant answers such as purchase ledger, sales ledger, cash book details etc.

Majority of the candidates have given correct answers for part (B) of this question.

It was noted from the answers that considerable number of candidates had no proper understanding about the financial statement assertions and therefore they have mentioned other audit procedures for the given points instead of identifying the financial statement assertions.

Overall performance for this question was at a satisfactory level.

Question No. 07 (Marks Allocated 10)

Part A (a) of this question required candidates to state two objectives of an internal control system and **part A (b)** required candidates to list two components of the COSO internal control framework. **Part B** was a scenario based practical question on identifying the internal control weakness and stating recommendations for the identified weaknesses as per the given scenario.

Almost all the candidates have mentioned correct objectives of an internal control system, whereas majority of the candidates has not answered the question on COSO framework.

Majority of the candidates have correctly answered **part B** also. However, a handful of candidates have given irrelevant answers such as foreign exchange risk, entering in to hedging contracts etc. Moreover, some candidates without understanding the question have mentioned no focus on collecting foreign customers' outstanding balances, related party transactions etc, as weaknesses.

Performance for this question was at an average level.

Section C

Two (02) compulsory questions only

Question No. 08 (Marks allocated 25)

This question included both theory and practical aspects.

Part (A) of this question tested knowledge on the types of audit procedures for obtaining audit evidence. Most of the candidates have obtained full marks for this part. But some candidates have given irrelevant answers such as audit evidence generated internally are more reliable when related controls imposed by the entity are effective, audit evidence obtained directly by the auditor is more reliable, etc.

Part (B) (a) tested the analytical procedures that the auditor could perform on inventories. Lesser number of candidates has given the correct answers such as calculation of stock turnover ratio and stock residence time. Most of the candidates have given irrelevant answers such as physical verification of inventories, cut off testing, checking of stock records etc., as the answer.

Part (B) (b) required candidates to list two additional audit procedures for the points given 1-4. This was a practical knowledge based question. It was noted from the answers that majority of the candidates have not understood the scenario as well as the question properly.

Part (B) (b) (1) - From this part examiner has tested Audit procedures required to verify the balances of debtors. Instead of writing the audit procedures pertaining to debtor balances, candidates have given irrelevant answers such as checking the age analysis of debtors, adequacy of the provision for bad & doubtful debts etc.

Part (B) (b) (2) - From this part, candidates are required to identify additional audit procedures to verify the payroll figures and salary ledger account. Most of the candidates have provided correct answers for this part. However candidates who have not understood the question have given possible reasons for the difference between the ledger and payroll such as fictitious employees being included in the payroll, over-payments to employees etc.

Part (B) (b) (3) - This required candidates to identify additional procedures when approved purchase orders are not available for purchase of Property Plant & Equipment items. However without understanding the scenario candidates have given irrelevant answers such as checking the serial order of purchase orders, match the GRN and the Purchase order details, etc. Only few candidates have mentioned about the board approval and the authorization of property plant equipment.

Part (B) (b) (4) - This required candidates to identify additional audit procedures when physical verification of property plant and equipments has not been carried out. Some candidates have given irrelevant answers such as valuation of PPE items, check the approval for acquisitions and disposals etc.

Part (C) required candidates to identify weaknesses in a given sample working paper. Majority of the candidates have obtained full marks for this part. However, some students have given wrong answers without reading the content of the working paper. Such students have mentioned name of the person preparing the working paper and the date of the preparation has not been given etc. However these facts were already included in the working paper.

Overall performance for this question was at a satisfactory level.

Question No. 09 (Marks Allocated 25)

This question included both theory and practical aspects.

Part A (a) - In this part of the question examiner expected candidates to explain the procedures that should be followed before accepting the appointment as an external auditor.

Majority of candidates have given general answers rather than giving specific correct answers. Some candidates have given irrelevant answers such as information about company & industry, agreement with related parties, agreement about the audit fees, about the rules and regulations of the company etc. Overall this question was very poorly answered by majority.

Part A (b) - In this part, the examiner has given an incomplete letter of engagement and required candidates to identify the missing items in it. Considerable number of candidates has given satisfactory answers but majority of the candidates have given poor irrelevant answers such as non-availability of the date, acknowledgement, signature, address, report reference etc.

Part B (a) - In this part, the examiner tested knowledge of the candidates regarding controls over input data. Here the examiner specifically tested the knowledge about controls over input completeness.

Most of the candidates have mentioned general controls in a computerized system. They have given answers such as,

- Use of passwords
- Restrict access to the system
- Review
- Compliance test
- Division of work
- Use of CCTV Cameras etc.

Since majority of the candidates have given general controls as answers only a very few candidates were able to score full marks for this part of the question.

Part B (b) - In this part candidates need to provide controls over input accuracy. It was noted that most of the candidates have not attempted this part.

Further some students have misunderstood the question and given answers related to the accuracy of input materials of a manufacturing organization although this question is related to the computerized environment. Examples for such irrelevant answers were as follows.

- Physical verification of inputs
- Appointment of responsible persons for observation
- Inspection
- Re performance
- Inquiry
- Use of reliable information
- System updates
- Keeping a backups etc.

Part (C) (a) - For this part candidates are required to give operating indicators that may cast significant doubt about the going concern assumption.

Although majority of candidates have attempted this question they have failed to read the question properly and understand the expectation of the examiner. Therefore most of the candidates have given financial indicators and other general indicators as their answers. Examples for such irrelevant answers are given below:

- Cash flow issues
- Decrease in sales
- Increase in liabilities
- Poor ratio indicators
- Weak internal control systems
- Continues Losses
- Obtaining loans to pay expenses etc.

Part (C) (b)

In this part of the question examiner required candidates to state audit procedures that the auditor could apply in performing going concern review. Majority of the candidates have given satisfactory answers for this part. However some candidates have given highly irrelevant answers such as;

- Recalculation of projects
- Re performance
- Substantive procedures
- Test of Controls
- Inspection
- Review of Internal Controls etc.

Overall performances of the candidates for this question were below the average level.

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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 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.