

Examiner's Report

AA3 EXAMINATION - JULY 2015

(AA34) PROCESSES, CONTROLS AND AUDIT

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 (Marks Allocated 05)

This question consisted of 02 sub sections and the theory knowledge on three parties involved in assurance engagement was tested from part (a) and the fundamental principles in the code of ethics were tested from part (b).

Performance for this question was fairly satisfactory. However some candidates have given irrelevant answers such as shareholders, internal auditor finance staff etc.

Further without having an idea about the action verb of "identify" candidates have given detailed explanations for the first part as well as code of ethics sections.

Question No. 02 (Marks Allocated 05)

This question tested the theory knowledge on matters to be included in an engagement letter for a recurring audit client from part (a) and the other information included in a permanent audit file from part (b).

For the part (a) only a handful of candidates have been correct in stating three matters to be included in an Engagement Letter and performance for this question was not satisfactory. Candidates have given matters included in the engagement letter but not the **matters to be included in an engagement letter for a recurring audit**. Most of the answers were irrelevant. Date of the report, type of the audit opinion, format of the audit report etc. are examples for such answers. The above flaws prove that a majority of the candidates have answered without having a proper knowledge about an engagement letter for a recurring audit.

Majority of the candidates have obtained full marks in stating other information included in a permanent audit file for the part (b). Several candidates have stated the information included in a current audit file instead of permanent audit file and therefore lose the marks.

Question No. 03 (Marks Allocated 05)

This part of the question tested the theory knowledge about the factors that influence the reliability of audit evidence from part (a) and the procedures an auditor may perform to identify possible related party transactions from part (b).

Performance for this question was satisfactory for the part (a) and majority of the candidates have obtained full marks by correctly stating two factors that influence the reliability of audit evidence.

For the part (b), many candidates have not correctly stated three procedures an auditor may perform to identify possible related party transactions. Most candidates have given methods of gathering audit evidence such as calling for confirmations, observations, re performance, analytical procedures etc. Further candidates have given explanations about the sufficiency and appropriateness of audit evidence instead of stating the audit procedures. This shows that the candidates did not possess an adequate knowledge about audit procedures of related party transactions.

Question No. 04 (Marks Allocates 05)

In this question examiner has tested the theory knowledge about general areas of that auditor should obtain knowledge under industry, regulatory and other external factors of GT Holdings PLC from part (a) and functions of Audit Committee from part (b)

Performance for this question was not satisfactory as a whole.

For part (a), the candidates have given irrelevant answers such as Information technology, Audit environment, internal control system etc. where the question was asked on the general areas that an audit manager should obtain knowledge under industry, regulatory and other external factors.

Further in part (b) of the question except for few candidates most candidates do not have any understanding about what is meant by the Audit committee. Candidates have identified audit procedures of the External Audit as Audit committee functions. Hence, this resulted in most

candidates getting low marks for this simple question. This highlighted that candidates should strengthen their knowledge regarding Audit Process and Corporate Governance

Section B- Three (03) Compulsory Questions

Question No. 05 (Marks Allocated 10)

This was a scenario based question about Fashions Trend (Pvt) Ltd. and comprised of three parts. Here the examiner tested the theory knowledge about the conditions or events which increase the risk of fraud in an entity from part (a), responsibility of the auditor when it comes to fraud from part (b) and Controls which could be considered to implement to mitigate the risk of under or over payment of salaries from part (c).

Performance for part (a) of the question is below the average. Some incorrect answers were noted such as legal issues, lack of knowledge etc. for part (a).

Some candidates have incorrectly mentioned that auditor is responsible in identifying the frauds when answering for the part (b) regarding the responsibility of the auditor when it comes to fraud. Therefore, it is important that the candidates should have an accurate and a conclusive knowledge about the responsibility of the auditor when it comes to fraud.

In Part (C) it is very clear that question is to identify the controls that could be considered to implement to mitigate the risk of under or over payment of salaries. However some candidates have given answers without understanding the question.

E.g.: They have given procedures of salary verification; check the salary details of payroll such as basic salary and allowances etc. with the personal files, Check the accuracy of EPF, ETF calculation etc.

Question No. 06 (Marks Allocated 10)

This part of the question examiner has tested the theory knowledge of candidates regarding the difference between professional skepticism and professional Judgment from part (a) and the audit procedures the auditor should perform to address the valuation assertion of closing inventories from part (b).

Some candidates have given acceptable answers for the part (a) of this question. Candidates have correctly mentioned that Professional Skepticism is an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud when Differentiating “Professional Skepticism” from “Professional Judgment.” But some candidates have given irrelevant answers such as professional skepticism is the basis for professional judgment and professional skepticism relates to past events of the organization and the professional judgment relates to the planning of future audit procedures etc.

Most of the candidates have not understood the part (b) of the question which required explaining two (02) audit procedures the auditor should perform to address the valuation assertion of the closing inventories. These candidates have given the inventory verification

procedure. Some candidates have given detailed inventory verification procedure more than one page and have wasted their time unnecessarily.

Very few candidates have mentioned the key point of this answer. That is the inventories should be valued at lower of cost or Net Realizable Value (NRV).

Question No. 07 (Marks Allocated 10)

This question too was based on the theory knowledge except part (B). From part (a) of this question examiner tested the knowledge of candidates regarding the persons who may not be qualified to get appointed as an auditor of the company and the process of appointing the first auditor of the company.

In this question reference has given to the companies act as a guide for answering. But some candidates have given irrelevant answers such as Bankrupt person, mentally disorder person, Person who has bad behavioral habits etc. Candidates who gave these irrelevant answers have not obtained marks. The above flaws prove that a majority have answered without having a firm knowledge of these theoretical aspects.

The part (B) of the question is to identify the type of the modified audit opinion issued in the given scenario and explain the possible reasons for giving such opinion. It is simple that answer is qualified audit opinion. This is because the auditor has not been able to obtain sufficient audit evidence as the auditor has been appointed later and as a result a qualified opinion is issued. Candidates were expected to explain on these grounds. But it was very unfortunate that some candidates have written the types of audit opinions and explaining irrelevant fact regarding the audit opinions. These candidates have wasted their time and as a result earned low marks.

Section C- Answer any two (02) questions only.

Question No. 08 (Marks allocated 25)

This question includes both theory and practical aspects.

It is expected to test five components of the internal control system framework from part (a) of the question. Compared to the other questions candidates have answered successfully for this part and more than half of the candidates have given the correct answers. However some candidates have given irrelevant answers such as cash management process, payroll process, Inventory management process, Fixed Assets management process, Analytical procedures etc.

Some candidates have not understood the part (b) of this question which required identifying three risks in a procurement process and stating a possible control to mitigate each of the identified risks. They have given wrong answers such as components of the audit risks. Not only they have given these wrong answers, they have spent time to explain in detail Inherent risk, control risk and detection risk which was not related to the question.

Majority of the candidates have answered well for part (c) (I) of this question. Most candidates have identified internal control weaknesses in the internal control system in the given scenario.

One common mistake was that these candidates have tried to explain these weaknesses in detail which was not required. However these candidates have obtained full marks for this part. Several candidates have not fully understood this part and they have given irrelevant answers for internal control weaknesses such as non-routine transactions not covered in the system, Human errors, collusion etc.

Candidates who answered well for the part (c) (i) have answered well for part (c) (ii) this part too. Candidates who misunderstood the first part have not obtained marks for this part also.

It was noted that majority of candidates have not attempted section Part (c) (iii). It was noted that few candidates have mentioned examples for preventive controls. Almost all candidates do not have any idea about detective controls.

Question No. 09 (Marks Allocated 25)

This question too includes both theory and practical aspects. It was noted that performance was very poor for this question as a whole. Further candidates had not attempted this question as they have given the option to answer any two questions out of three questions of the Section (C).

It is expected to test the knowledge of elements of a quality control system under part (a). Candidates' knowledge regarding the quality control system of an audit was very poor as most candidates have understood it as quality control mechanisms of the production line. There was large number of irrelevant answers such as checking the production date, manufacturing date and packing date, upgrade the standards of the product finishing line, use of knowledgeable supervisors, quality managers, Obtaining ISO certificates etc. This highlighted the poor knowledge shown by the candidates in explaining the elements of Quality Control System.

It is expected explaining the purpose of implementing IT general controls in an entity under part (b) (i). The expected answer as the purpose of implementing IT general control was to establish framework of overall control over the computer information system's activities to provide reasonable level of assurance that the overall objectives of the internal controls are achieved. However some candidates have stated incomplete and generic answers such as make sure all information are available for decision making process, minimize errors, increase the supervision etc.

The practical knowledge was tested about controls an organization can consider to prevent or detect unauthorized changes to computer programs under part (b) (ii) and majority of candidates have given correct answers for B part ii. Most of the candidates have mentioned the access controls, password protection etc. and earned marks.

Majority of the candidates who attempted for this question have ignored part (c) which was a scenario based question about Design Furniture (Pvt) Ltd. In the part (c)(i) it was required to state five risk assessment procedures based on the given scenario Which could be performed in order to identify and assess the risk of material misstatements. Candidates who answered for part (c) have failed to understand this question. Most candidates have given answers such as observation, analytical procedures, and calling conformation etc. as their answers for this part. Therefore candidates have obtained very low marks for this part.

For part (c) (ii) it was expected to identify three areas which need to focus on when performing the audit based on the given information. Candidates have given lot of irrelevant answers such as internal control system, purchasing area, Fixed Assets controlling system etc. This shows

that candidates did not possess an adequate knowledge about the risk assessment and applying the knowledge into practical scenarios.

Question No. 10 (Marks Allocated 25)

Candidates have obtained fairly satisfactory marks for this question except part (a) of this question.

Part (a) of this question examiner tested the knowledge on financial events or conditions that may cast doubt about the going concern assumption in preparation of financial statements. Here examiner has mentioned specifically to state financial events or conditions that may cast doubt about the going concern assumption. But when answering to this question candidates have ignored the fact and stated operational and other conditions.

Part (b) was a scenario based question about Flex Plastic (Pvt) Ltd. From part (b) (i), it was expected explaining "Observation" which is a type of audit procedures and state limitations of "Observation" as an audit procedure. Most candidates have answered well for part (b) (i).

From part (b) (ii), the examiner tested the knowledge about the analytical procedures which would perform to obtain audit evidence on inventories of this company as at 31.03.2015. It was noted that a considerable amount of candidates do not have clear idea about analytical procedures. Candidates have given incomplete or irrelevant answers such as physical stock verification, Calculation of Weighted Average Cost, Inspection of documents, etc.

Several candidates have not answered for the part b (iii) which was based on the audit procedures to check the accuracy of valuation of raw materials as at the financial year end. Examples for irrelevant and incomplete answers such as Check the invoice, Recounting etc.

Part (c) of the question was based on a working paper prepared by an audit junior on trade receivables. Here the (C) (i) question is to explain weaknesses in terms of the adequacy of the audit procedures performed by the junior on the debtors confirmation process stated in the given scenario. Candidates have just given answers such as "No proper controls over confirmation process" etc. instead of explaining the identified weaknesses

From part (c) (ii) the examiner has tested the knowledge on identifying weaknesses noted in the given working paper. Majority of the candidates have answered successfully for this section.

Most of the candidates have mentioned the documentation issues such as date of the preparation of working paper not stated, basis of selection of sample to send confirmation not documented, working paper reference is not available etc. and obtained the full marks.

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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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