

## Examiner's Report

### AA3 EXAMINATION - JANUARY 2018

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

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#### General Comments

#### **Analysis of the Question Paper, Answers, Strengths & Weaknesses of the Candidates:**

Processes, Controls, and Audit (AA34) included nine (9) compulsory questions based on the study text (Both theory and its application). There were three (3) sections in this question paper; **Section A** contained four (4) compulsory questions carrying five (5) marks each, **Section B** contained three (3) compulsory questions carrying ten (10) marks each, and **Section C** contained two (2) compulsory questions carrying twenty-five (25) marks each.

Most of the questions contained in the question paper was based on the study text (Both theory and its application). If the candidates have studied the study text and practiced answering past paper questions of at least last five years, they could have easily obtained more than 50 marks to get through this paper. We have noted that most of the candidates have the subject knowledge however, they are lack with practice as to how the answers should be formulated based on the subject matter.

The Overall Performance of the candidates for this paper was satisfactory, and there were candidates who were able to obtain marks over and above 75, and they have answered all the questions systematically by managing allocated time for the paper. However, there were significant number of candidates who have obtained less than 25 marks.

Majority of candidates have attempted and answered almost all the questions in the paper, however, some parts have not been answered by some other candidates. Those have not been answered mainly due to poor time management, lack of knowledge, lack of understanding of the questions in the paper. Apart from the above, the following general observations were noted during the marking process;

- Lack of analytical skills.
- Illegible hand writing.
- Writing short answers where high marks were available.
- Writing lengthy answers where low marks were available.
- Have identified the issues in the case study but have not answered in line with the questions.
- Have not planned the answers and ended up with providing irrelevant answers.
- Have not understood the "Action Verb" given in the question.

## Section A

### Four (04) Compulsory Questions

**Question No. 01** (Marks Allocated 05)

The question was to test the components of external environment affecting the business of **Tastee Ltd.** Most of candidates have understood the question correctly and provided clear answers to earn satisfactory marks. The overall Performance of the question was satisfactory and most of the candidates were able to secure full marks, however there were candidates who have not obtained marks, as those answers were not related to the question. Those candidates have mentioned components of external environment as transportation, corporate governance, creditor and debtors, communication environment and quality controls, etc.

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

This question was to test the knowledge of students regarding Corporate Governance, specially the functions of audit committee and remuneration committee. Overall Performance of this question was average, and a few candidates were able to secure full marks, and majority of the candidates were able to secure average marks between 2 to 3. Most of the answers given by the candidates were incomplete and irrelevant. Further, it was noted that the candidates were unable to differentiate the functions between the audit committee and the remuneration committee. Most of the candidates have mentioned issuing audit reports, preparation of audit reports, expressing an audit opinion, preparing business plans, detecting errors, conducting external audit, etc., as the functions of Audit Committee and have mentioned evaluate profit and growth, deciding remuneration of the external auditors, analyze the revenue of the company, sending salaries of the employees on due dates, etc., as the functions of Remuneration Committee.

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

This question was to test the knowledge of candidates regarding the elements of a system of quality controls. The performance of this question was at an average level and very few candidates were able to secure full marks. It was noted that the most of candidates have mixed up the question with the quality control procedures of a manufacturing organization and given their answers accordingly and no marks were given for those answers. There were significant number of irrelevant answers such as, accuracy, reliability, timeliness, comparability, checking the quality of finished goods, setting quality standards in manufacturing process, segregation of duties, etc., given for the elements of a system of quality controls.

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

This question consisted of two parts, part (a), the examiner tested an example for a Reasonable Assurance engagement and part (b) tested the reasons for expressing an opinion in a negative form by a practitioner in a Limited Assurance Engagement. Almost all the candidates have given correct answers for part (a), and thereby performance was satisfactory, however, the performance for the part (b) was at an average level. This was mainly due to not understanding the questions properly by candidates and as a result they have given significant number of irrelevant answers for which no marks were given. Examples for those irrelevant and incorrect answers are scope limitation, lack of audit evidence, materially misstated information, existence of human errors, refusals from client staff to provide information required for the audit, etc.

**Section B**

Three (03) Compulsory Questions

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

This question consisted of two main parts, under part (A) (a), it has been tested the meaning of sufficiency and appropriateness of audit evidence, under part (A) (b), it was required to explain the term “External confirmation” with an example.

Performance for the part (A) (a) was satisfactory and most of the candidates who attempted the question were able to obtain full marks. However, there were candidates who have given wrong answers such as level of audit risk, all evidence used by auditors, documents need for audit evidences, the evidence should be original and authorized by the responsible officer, etc., for the meaning of sufficiency and appropriateness of audit evidences.

The performance for the part (A) (b) was satisfactory. Most of the candidates were able to secure full marks for this part of the question, however, there were irrelevant answers such as getting the audit done from third party, financial statements reviewed by third party, inventory verification done through an outside party, etc., for external confirmations.

Under part (B), there was a mini case study given in relation to a defined employment benefit plan where estimations have been done by a qualified actuary. From this question, it was required to explain the matters that need to be considered in assessing the appropriateness and adequacy of the actuary’s work as work performed by an expert. Most of the answers were not upto the standard and law marks were awarded, however, there were couple of candidates who were able to secure high marks, and it was mainly due to understanding of the question very clearly by those candidates. There were incorrect answers given such as check whether all the work has been completed by the actuary, check the integrity of the actuary etc.

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

This question consisted of two main parts, under (A) (a), the examiner tested the purpose of an engagement letter and part (A) (b) tested the knowledge of the candidates regarding the factors that auditor may decide to revise the terms of an audit engagement letter. The performance for both parts of the questions was satisfactory, and most of the candidates were able to secure full marks. However, some have mentioned that the purpose of an engagement letter is to provide information required for the audit, to inform the audit procedures and to express an audit opinion.

Under part (B), there was a mini case given in relation to accepting an audit engagement to review the internal controls of the company by the partner engaged in the statutory audit of the same company. It was tested the knowledge of the candidates regarding the threats to independence of the auditors with respect to the audit and acceptance of the proposed engagement. Overall performance of this part of the question was satisfactory, and most of the candidates have written all the threats without relating to the case study for which higher marks could not be given. However, there were candidates who have given answers related to the mini case study and obtained reasonable marks.

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

This question was to test the knowledge of candidates regarding audit report and audit opinion. Part (a) of the question was to test the instances when an auditor should express an unmodified audit opinion. Part (b) (i) required to explain the reason as to why the auditor should include an emphasis of matter paragraph in the auditor's report. Part (b) (ii) tested examples of circumstances where the auditor includes an emphasis of matter paragraph.

Most of the candidates have attempted the question and fair numbers of candidates have given the correct answers and able to secure full marks. Based on the answers, it was noted that some candidates have no knowledge about the unmodified opinion and ended up with giving wrong answers that unmodified opinion is issued when there is a scope limitation, could not be able to obtain appropriate audit evidence, disagreement with management etc.

The performances for the part (b)(i) and (ii) were at an average level. There were few candidates who were able to secure full marks by providing appropriate answers. Majority of the candidates have not understood the questions properly as a result they have given wrong answers such as,

- the emphasis of matter paragraph is given in the audit report when there is no audit evidence,
- auditor expresses an adverse opinion or qualified opinion when there is lack of accounting records and inadequate audit evidences, etc.

## Section C

Two (02) compulsory questions only

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

### Part A

This question tested the knowledge of candidates in various areas such as identification of internal control weaknesses, recommendations to overcome those weaknesses and IT general controls. The questions under this part based is on the case study and there were four (4) sub questions based on the case study. The knowledge of the candidates on application of theories was at a very poor level. This indicates the lack of knowledge of candidates in applying the theory to a real business environment. It also indicates the lack of practice of candidates in working out similar questions in the past papers prior to the examination.

- (a)** It was required to identify internal control weaknesses in the sales process given. Most of the candidates have studied the case study very well and were able to provide satisfactory answers to obtain full marks. It was a very simple question. The questions have set in a manner in which an average candidate could have easily gathered those points from the question itself. However, there were fewer number of candidates who have not attempted this part of the question. Most of the candidates have written, locating the show room and stores in one place, non-availability of qualified chartered accountant, non- availability of CCTV cameras, as major weaknesses in the process mentioned and ignored other critical control weaknesses.
  
- (b)** This part is related to part (a) above and the examiner requested to provide recommendations for the weaknesses identified under part (a) above. The performance for this question was satisfactory and most of the candidates could secure full marks for this part of the question, however, there were considerable number of candidates who were unable to obtain marks for this question, due to ignorance of the critical internal control weaknesses when giving answers for part (a). Accordingly they have mentioned recommendations such as fixing of CCTV cameras, employing a qualified chartered accountant, locating the office and the stores in separate places etc.

### **(c) and (d)**

By these questions the examiner tested what the IT General controls that should exist in a computerized information system for invoicing, stock maintenance, and other financial processes and examples for such IT General Controls based on the facts given in the case study. The performance for this parts of the question was below the average level and most of the candidates were not able to understand the question, and provided with unsatisfactory answers. Only a handful of candidates were able to secure satisfactory marks for this question. The candidates who have mentioned wrong answers for part (c) were not been able to obtain marks for part (d) as well.

## **Part B**

Under this part of the question, the examiner tested the knowledge of the candidates on the key elements of an assurance engagement to be performed by the external auditor to provide an assurance report. The performance for this part of the question was satisfactory and most of the candidates were able to secure full marks. However, there were candidates who have given wrong answers and ended up with zero marks. Some candidates have explained the process of auditing, type of assurance engagements, for the key elements of an assurance engagement.

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

- (a)** This question required candidates to identify three general areas of business that they need to consider when understanding the entity and its environment with an example for each. As this was a very simple question, the performance for this part of the question was above the average. There was considerable number of candidates who could able to obtain satisfactory marks. However, fewer number of candidates, without properly understanding the questions, have given wrong answers such as review audit permanent file and audit working papers to understand the business environment. It was also observed that some candidates have not attempted this part of the question.
- (b)** This part consisted of three sub questions based on the mini case study relating to the inventory of **Tiara Ltd.**
- (i)** Under this part, it was tested regarding the audit risk related to inventory. The performance for this part of the question was at an average level. Majority of the candidates have not understood the question properly. Instead of recognizing the audit risk related to the inventory, they have recognized the business risk of having inventories, such as risk of having excessive inventory level, risk of accepting goods without referring to order details etc. As those were not related to audit risks, no marks were awarded for those answers.
- (ii)** Under this part the examiner tested the audit procedures that need to perform in response to the audit risks explained under **(i)** above. The performance for this part of the question was at an average level, and only a very few candidates have understood the question and able to secure satisfactory marks. However, many candidates without mentioning the audit procedures to perform in response to the audit risks identified in **(i)** above, have given answers relating to internal controls to mitigate the audit risks such as placing orders considering economic order quantity, regular monitoring of maximum inventory level, checking goods received notes against order details etc. and failed to earn marks.
- (iii)** Under this part, it was tested the substantive procedure that would perform to test the valuation of the year-end inventory. The performance for this part of the question was at an average level, and only a handful of candidates were able to secure satisfactory marks. Many candidates without properly understanding the question, have given irrelevant answers such as checking the internal control related to the inventory, regular conduct of stock verification, calling confirmations from suppliers, etc., as the substantive procedures to test the valuation of year- end inventory balance.

- (c) (i) It was required to compare “Inquiry Vs Observation” with examples, and the performance for this part of the question was satisfactory and most of the candidates were able to secure high marks. However, there were candidates who have not understood the question and given wrong answers without comparing inquiry and observation. For an example, most of the candidates have written that observation is better than inquiry without explaining the meaning of the two terms. Further those candidates have mentioned inspection of sales invoice to ensure that correct customer have been invoiced and correct amount have been taken into accounts and inspection of bank statements to check the bank balance as examples for observation.
- (ii) It was required to compare “Re-calculation Vs Re-performance” with examples. The performance for this part of the question was good and most of the candidates were able to secure satisfactory marks. However, there were candidates who could not able to secure marks due to not correctly identifying the difference between “Re-calculation and Re-performance”.
- (d) It was required to identify audit procedures that need to be performed on the reconciliation of supplier’s statement given in the question. The performance for this question was below the average and based on the answers, it was noted that candidates are lack in understanding the practical issues and providing satisfactory answers thereon to earn high marks. There were significant number of wrong answers such as carrying out physical verification, checking all invoices, checking all payment vouchers and checking all returns without referring to the facts given in the reconciliation. However, only a very few candidates were able to provide satisfactory answers and earn full marks for the question.

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**Suggestions to enhance the Competency Level of Candidates in order to Improve Performance at the Examination:**

- Candidates must study the study text and understand its contents.
- Refer articles, magazine in relation to this subject and other reading material related to auditing.
- Understand the definition of action verbs and practice as the candidates have to answer the question based on the action verbs list given at the end of the question paper.
- Study the contents of the past papers and practice at least last five years' examination papers and try to understand the way in which the questions are being set.
- The candidates should understand the relationship between the theory given in the question papers and examiner's expectation of its application at the examination.
- The candidates should study and understand as to what areas in the study text have been tested in the past question paper and make short notes of those areas in the study text.
- The candidate should practice answering the past paper question based on the time given in the question papers and accordingly, it will improve the time management at the examination.
- Write short notes of each study chapter given in the study text and study as and when you get free time to remember the contents of syllabus
- Candidates should write legibly at the examination.
- The candidates should carefully read the instructions given in the examination paper prior to start answering the questions in the paper.
- The candidates should have a clear and balance mind set at the examination in order to understand the question and provide with appropriate and accurate answers required in the question.
- The candidates should allocate time for the questions based on the marks given and accordingly, the candidate should effectively be able to answer all the questions given in the paper.
- Answers should be numbered appropriately and accurately as given in the question paper.
- Very important to understand the relationship between theory and its application in the question, wherever requested, write with examples.
- Check twice whether all required questions were answered and appropriately numbered prior to hand over the answer scripts.