

EXAMINER'S REPORT**AA3 EXAMINATION - JANUARY 2020****(AA34) PROCESSES, CONTROLS AND AUDIT**

(AA34) Processes, Controls, and Audit, 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.

The entire question paper was based on self-study text (Both theory and its application), and it tested the theoretical, and its application especially in last two questions. If the candidates had studied the study text and practiced answering past paper questions of last years, they could have easily obtained more than 50 marks to get through this paper. Most of the candidates have the subject knowledge, however, they do not have awareness as to how the answers should be formulated on the question given in the question paper 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 high marks, and they have answered all the questions systematically by managing allocated time for the paper.

Majority of candidates have attempted and answered all questions in the paper, however there were some parts of the questions which were not answered. This happened mainly due to poor time management, lack of knowledge and 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 and application knowledge.
- Illegible hand writing.
- Writing short answers for the questions where high marks were allocated.
- Writing lengthy answers for the questions where low marks were allocated.
- Identified the subject matter in the given case study questions but not answered in line with the questions.
- Not planned when the answers are buildup and as a result of it provided irrelevant answers.
- Not considered the “Action Verb” given in the question when answered.
- Not understood the examiner’s expectation in the question.

Section A
Four (04) Compulsory Questions

Question No. 01

The question tested the knowledge on types of business organizations and business environment. Majority of the candidates were able to understand the requirements of the question and obtained full marks.

In **part (a)** of the question asked the types of business organizations that can be started by two graduated friends. However very few of candidates had mentioned sole proprietorship as the answer. This indicate that those candidates do not understand the fact that those organization is not suitable for the friends to start the business.

In **part (b)** it was required to state economic factors affecting the business. However, some students had mentioned irrelevant answers like political, legal, social and environmental factors as economic factors affecting the business.

Candidates should have knowledge on following areas to give successful answer for these types of questions:

- Types of business organizations.
- Characteristics of business organizations. (Eg. Objectives, No. of members. etc.)
- Identification of business environment (Internal environment, External environment)
- Forces of External environment. (Economic, Legal, Technical, Social)
- Factors of environment forces (Eg. For Economic force - Exchange rates, Interests rates, Taxation)

Overall performance of this question was at satisfactory level.

Question No. 02

This question tested the knowledge on going concern assumption, which is a fundamental principal in the preparation of the financial statements. The auditor should remain alert throughout the audit for evidence of events or conditions that may cast significant doubt on the entity's ability to continue as going concern. Therefore, they should be able to clearly identify financial and operating events that may cast significant doubt on the entity's ability to continue as going concern.

Most of the candidates have understood events or conditions that may cast doubt on going concern. However, they were unable to distinguish operating and financial events separately and they could not get allocated marks.

Overall performance of this question was at average level.

Question No. 03

Part (a) of the question asked situations where auditor cannot be expected to detect all material related party transactions. To score full marks, students should have knowledge on,

- What is related party?
- Responsibility of management relating to related party transactions.
- Responsibility of auditors relating to related party transactions.

Only few candidates were able to obtain full marks for **part (a)**. Majority of candidates had no adequate knowledge on above areas though it was directly tested from study text.

In **part (b)** it is required to list three audit procedures other than stated in the question. However, students have repeated same audit procedures and some have mentioned general audit procedures which are not related to obtaining evidence for related party transactions.

Overall performance of this question was at average level.

Question No. 04

The question tested the knowledge on quality control procedures to be performed at the firm and individual audit engagement level. Under **part (a)** it was tested the activities included under review when conducting individual audit engagements and it was noted that many of the candidates had given general activities such as followings without considering the theoretical knowledge:

- Rechecking working papers.
- Evaluating audit reports.
- Re perform audit procedures.
- Preparation of financial statements.

In **part (b)** it was tested the elements of quality control system maintained at the firm level and many candidates have obtained full marks. However, few candidates had given irrelevant answers.

This indicates lack of knowledge on quality control procedures and its elements.

Overall performance of this question was at average level.

Section B

Three (03) Compulsory Questions

Question No. 05

The question tested the knowledge on nature of evidence an auditor should obtain in order to express a conclusion which enhance the degree of confidence of the users.

Part (a) asked to explain what is meant by sufficient and appropriate evidence.

Sufficiency means large enough quantity of evidence and appropriateness means reliability and quality of the evidence. Most of the candidates have obtained satisfactory marks, but few of candidates were unable to explain the proper meaning.

Majority of unsuccessful candidates have written irrelevant points and some of them repeated the details given in the question.

In **part (b)** tested the ability of the candidates to identify requirements which should be performed when accepting and continuing the assurance engagement. Many candidates had mentioned many steps which can be performed by the auditor since study text explains many steps.

Overall performance of this question was at satisfactory level.

Question No. 06

Candidates were requested to assess the matters affect the audit opinion of Sara Trading's Financial Statements. Sara Trading had not depreciated office building for three months which is Rs. 01 Million and it is not exceeding the materiality level of Rs.1.7 Million.

Sara Trading has capitalized borrowing costs of Rs. 1.5 Million after completion of construction which need to be charged to the P & L. This amount also does not exceed the materiality level. However, when considering both misstatements together, then it is material to the financial statements.

However, there were only very few candidates assessed this impact based on the financials. This indicates lack of ability of candidates to draw a correct conclusion in a practical situation using their technical knowledge.

Part (b) is a straightforward question and tested the theoretical knowledge. Candidates were requested to recognize the types of audit opinions to be expressed if the auditor is unable to obtain sufficient and appropriate audit evidence. However, few candidates mentioned that qualified opinion should be expressed when auditor is unable to obtain sufficient and appropriate audit evidence but most of them have not considered the material and pervasiveness which affect to disclaimer of opinion.

Overall performance of this question was at poor level.

Question No. 07

Part (A) of the question tested the procedures that should be followed when replacing an existing auditor by the company and procedures that should be followed by new auditor after accepting the appointment. This was directly tested from the study text.

Performance for both **part (a)** and **(b)** were poor due to lack of knowledge on procedures relating to appointment and replacement of an auditor. Many of the candidates have written irrelevant general answers like Obtain approval from Board of directors, inform the shareholders, inform to the registrar of companies for **part (a)**.

Part (B) of the question requested to state situation where auditor can disclose confidential information. Considerable number of candidates have given correct answer. However, there were irrelevant answers such as,

- When find a material misstatement in the financial statements.
- When company engage in related party transaction.
- To safeguard the company from any damage etc.

Overall performance of this question was at poor level.

Section C

Two (02) compulsory questions

Question No. 08

The question was case study based question and tested the knowledge on Corporate Governance, Internal controls, Control environment and IT controls.

Part (a), (b)

Part (a) and **(b)** tested the knowledge on corporate governance and its guidelines.

Part (a) tested the guidelines to be followed by the directors as per the corporate governance. Very few students were able to mention guidelines clearly. Most unsuccessful candidates mentioned whatever task relevant to the directors and management of the company such as,

- Preparation of financial statements.
- Controls on purchasing, sales and stocks.
- Segregation of duties.

Part (b) tested the knowledge on committees that should be established as per the corporate governance guidelines. Majority of students mentioned at least one committee.

Very few of candidates provided the irrelevant answers like Fraud prevention committee, Purchasing committee, Sales committee and Management committee, etc. and not obtained marks.

Part (c), (d)

The performance for **part (c) & (d)** was at satisfactory level. The question clearly presented the eight sound controls adopted by the company in relation to its procurement process and students were expected to identify only five of those and in part (d) students were requested to state the relevant objective of those procedures. Majority of candidates were able to obtain high marks for this part. The reason may be the question itself includes many points relating to the answer and students were able to get full marks using their basic subject knowledge.

Part (e)

Tested the knowledge on elements of control environment and three control activities to be established by **HL Hotels PLC**. To earn marks for this part, candidates should have clear understanding on relevant subject matters. Performance for this part was poor due to lack of knowledge on elements of control environment and control activities. Most of the candidates had written irrelevant answers.

Part (f)

Majority of the candidates attempted this part and the students were able to list general controls that should be in place to prevent unauthorized amendments to data files. Average number of students were able to list application controls to be available to control over accuracy of inputs.

Students those who didn't have required competency had mentioned whatever controls relating to IT without considering the difference of general controls and application controls.

Overall performance for this part of the question was at satisfactory level.

Question No. 09

Part (a)

It was required to state four reasons why proper planning of an audit is required. Most of the candidates answered well and scored full marks.

Part (b)

It was required to list five sources that can be used to get an understanding on **Srina Fabrics PLC**.

Performance was at average level but few candidates answered giving the relevant points relevant for **part "C"** of the question.

Some candidates scored reasonable marks reproducing the sources given in the question even though they did not have proper subject knowledge.

Most of the unsuccessful candidates mentioned about the supporting documents and ledgers, which can be used as sources to get an understanding on **Srina Fabrics PLC**.

Part (c)

By this part of the question, it was required to identify six areas that auditor need special attention in performing audit procedures of **Srina Fabrics PLC**.

Examiner expected to have very basic knowledge and just to identify the areas based on given information in the question. (So many areas relating to debtors)

Significant number of candidates misunderstood the question and mentioned about the areas of business an auditor needs to have an understanding like nature of the entity, Industry, regulatory & other external factors, Internal Controls, Objectives & strategies and related business risks, selection & application of accounting policies.

Part (d)

It was required to list four audit procedures that need to be performed in auditing debtors' balance. Successful candidates who had the proper subject knowledge with practical application were able to score marks at a satisfactory level.

Unsuccessful candidates wrote only the types of audit procedures without linking to the debtors such as Inquiry, Observation and Inspection.

Some unsuccessful candidates misunderstood the question and wrote procedures which can be followed by the company relating to debtor's management as, give discounts to promote Recovery, reduce credit period and Make Provision, etc.

Part (e)

It was required to explain three types of audit procedures for obtaining the audit evidence and most of the candidates scored full marks easily.

Some candidates faced difficulty in explaining observation and inspection.

Few candidates provided following irrelevant answers:

- Test of controls / Test of details / substantive audit procedures.
(Broad level of audit procedures but not types).
- Written evidence is more reliable than verbal evidence, etc.

Overall performance for this question was at satisfactory level.

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

- (1) Candidates must study the study text and understand its contents.
- (2) Refer articles, magazines in relation to this subject and other reading materials related to auditing.
- (3) Understand the definition of action verbs and practice to answer the questions based on the action verb list given at the end of the question paper.
- (4) Study the contents of the past papers and practice at least last 2-3 years' examination papers and try to understand the way in which the questions are being set.
- (5) The candidates should understand the relationship between the theory given in the question papers and examiner's expectation of its application at the examination.
- (6) The candidates should study and understand as to what areas in the study text have been tested in the past question papers and make short notes of those areas in the study text.
- (7) The candidates should work out the past paper questions on timely basis before the examination, it will improve the time management at the examination.
- (8) 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.
- (9) Candidates should write legible hand writing at the examination.
- (10) The candidates should carefully read the instructions given in the question paper prior to start answering the questions in the paper.
- (11) 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.
- (12) The candidates should allocate the time for the questions based on the marks given and accordingly, the candidate should be able to answer all the questions given in the paper effectively.
- (13) Check twice whether all required questions were answered and appropriately numbered prior to hand over the answer scripts.