

**EXAMINER'S REPORT****LEVEL III EXAMINATION - JANUARY 2023****(303) FINANCIAL CONTROLS & AUDIT**

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(303) Financial Controls, and Audit, comprises 9 compulsory questions. There were 3 sections in this question paper; **Section A** includes 4 compulsory questions carrying 5 marks each, **Section B** contains 3 compulsory questions carrying 10 marks each, and **Section C** contains 2 compulsory questions carrying 25 marks each.

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 was mainly due to poor time management, lack of knowledge on certain syllabus areas and lack of understanding of the requirement of the questions.

**Section A****Question No. 01**

**Part (a)** of the question requested to explain whether you agree with the statement given by the secretary.

Majority of the candidates had mistakenly stated that they agree with the statement and earn lower marks. This indicates the candidates poor knowledge on stewardship theory and agency theory.

The study text clearly stated that,

- The directors are the stewards of the company and
- The shareholders are the principal employing the directors as agents to run the company on their behalf.

So, candidates are advised to give fair attention to the content of study text.

**Part (b)** of the question requested to explain the term “fiduciary relationship”.

Performance was at an average level. The study text clearly stated that where one person has a duty of care towards someone else it is known as fiduciary relationship”.

Candidates are advised to have a fair knowledge on following area:

- Agency theory
- Stewardship theory
- Fiduciary relationship
- Agency conflict
- How audit provides a mechanism to ensure directors fundamental stewardship role.

## **Question No. 02**

From this question it was required to identify the type of risk the company has faced and most appropriate risk mitigating technique for each identified risk.

Most of the candidates had identified the type of risk but were unable to mention appropriate risk mitigating technique. Answer should be given understanding the nature of the business based on company's point of view.

Some of irrelevant answers provided by candidates are as follows:

- Presenting inaccurate information – finance risk
- Customer rejection of products – operational risk
- Increase in interest rates – finance risk

Candidates are advised to improve their knowledge on following areas,

- External and internal risk of organization
- Risk management framework
- Techniques used in mitigating risk
- Risk management and information technology

## **Question No. 03**

The question required to explain the respective role of parties of three-party relationship which is one of the five elements of an assurance engagement and how they relate to each other.

Performance for this question was poor.

Most of the candidates had not clearly understood the requirement of the question.

There were two requirements in the question:

- Explain the role of the three parties as an element of the assurance engagement.
- Explain how they relate to each other.

Candidates had written whatever they know about three party relationship without understanding the exact requirement of the question. Though majority has identified the three parties of assurance engagement, they did not give the answer how they relate to each other.

So, candidates are advised to understand the requirement of the question properly and improve subject knowledge on following areas:

- Assurance engagement and difference between reasonable assurance and limited assurance engagement.
- Elements of assurance engagement.
- Requirement when accepting and managing assurance engagement.
- Related services.

#### **Question No. 04**

This question is based on quality control at the firm level and on an individual audit level.

Performance was very poor.

Most of the candidates had no understanding on system of quality control at the firm level and on individual audit level. They had given answers using the general knowledge on leadership responsibility and supervision without understanding the question. This has been included in study text also.

For leadership responsibilities, they had mentioned irrelevant answers such as:

- Monitoring
- Control
- Communication
- Motivation etc.

Candidates should improve knowledge on:

- Objective of system of quality control
- Elements of system of quality control
- Quality control requirements apply for an audit of financial statements.
- Acceptance and continuance of client relationship and audit engagement.

### **Section B**

#### **Question No. 05**

**Part (a)** of the question was required to identify three benefits that an auditor would derive by adequate planning of an audit.

Performance was at an average level.

Some candidates had provided general answers such as:

- Increase efficiency and effectiveness of audit
- Cost control
- Increase efficiency in operation of client business

**Part (b)** required to state three areas that the auditor should obtain an understanding of **Star Lanka (Pvt) Ltd.**

This was an easy question and study text mentioned many areas the auditor shall obtain an understanding of the clients entity.

The performance was at an average level.

There were some irrelevant answers as follows:

- Payment process.
- Distribution process.
- Inventory report.
- Bank statements.

**Part (c)** required to explain the preliminary engagement activities that the auditor should perform at the beginning of the current audit engagement.

Performance was very poor.

Candidates had not understood the requirements of the question and had provided following irrelevant answers such as,

- Review previous audit files.
- Check Internal Controls.
- Check related party transactions.

They missed the word 'preliminary engagement activities of beginning of the current audit engagement'.

## **Question No. 06**

**Part (a)** required to explain the responsibility of the auditor in preventing and detecting fraud in an entity.

Most of the candidates had missed **the** following important points:

- Primary responsibility for the preventing and detecting of fraud rests with those charged with governance.
- Owing to the inherent limitations, there is an unavoidable risk that some material misstatement of the financial statement may not be detected.

Many candidates had stated that preventing and detecting fraud is the responsibility of the auditor.

Performance was at below average level.

**Part (b)** required to identify procedures to be followed by the auditor to reduce the audit risk on fraud.

Performance was at a satisfactory level.

However a significant number of candidates had mentioned general audit procedures such as,

- Inspection, observation, inquiry, etc.

Some had provided totally irrelevant answers such as:

- CCTV installation
- Security guards

The following procedures should be mentioned to secure full marks allotted for this part.

- Identify risk of material misstatement of the financial statements due to fraud.
- Obtain sufficient appropriate audit evidences regarding the assessed risk
- Respond appropriately to fraud or suspected fraud identified during the audit.

**Part (c)** required to explain areas to be communicated with TCWG in conducting the audit.

Performance was not at a satisfactory level. Answers for this part are given clearly in study text.

There were irrelevant answers such as:

- To obtain an understanding the entity.
- Financial report framework.
- Accounting policy and procedures.
- Accounting standards.

### **Question No. 07**

**Part (a)** required to discuss matters you will consider and communicate to the partner in accepting Audit engagement of **Reliable PLC**.

This was a very easy question because the question itself includes the matters to be considered and communicated.

However, performance was not at a satisfactory level. The main reason for this may be due to not understanding the requirement and not read the question with due attention.

If candidates had read the question carefully, full marks could have been obtained without much effort.

Some candidates provided irrelevant answers such as:

- Ethical requirements.
- Planning and performing audit.
- Audit documentation.

**Part (b)** required to explain the safeguards available to an auditor in relation to threat of professional competence and due care in accepting a new audit client.

Direct answers could have been given and they have been given in study text.

Performance was not at a satisfactory level.

There were irrelevant answers such as:

- Review previous years audit reports.
- Discuss with management.
- Getting management representation.

### Section C

#### **Question No. 08**

**(a)** This part of the question required to identify four internal control weaknesses of **Osu Medura (Pvt) Ltd.** Answer could be taken question itself easily. Almost all the candidates attempted this part and considerable number of candidates scored more than 02 marks out of the allocated marks. Study text clearly mentioned internal controls that an entity should have irrespective of its size and nature of operations.

Following internal control weakness could have easily found from the given information:

- (1) **Dr.Roshan** who is medical professional performing functions of an accountant.
- (2) **Kalpani** who is a pharmacist performing accounting functions.
- (3) **Dr.Roshan** places orders for pharmaceutical products by relying on balances on computer.
- (4) Payments for purchases are done base on suppliers' invoices without checking with purchase order and GRN.
- (5) Practically CDM machines accept only notes. That would mean coins that are kept in a separate drawer are not banked and that violates the principle that 'all revenue should be banked intact'.

Some candidates had given irrelevant and general answers such as:

- No credit sales take place.
- Not having finance department.
- Only Maharagama branch handles purchases and payments.

**(b)** This part of the question requested from the candidates to explain the meaning of 'system of internal control'. Performance was at an average level and most of candidates had given general answers and explain in their own words. In AAT curriculum, 25% was allocated for internal control system and business processes, some candidates did not know the meaning of internal control system. The study test clearly explains the meaning of 'system of internal control'.

Therefore candidates are advised to devote necessary attention for the relevant study text.

- (c) This part of the question required to state five elements of control environment. Performance was at an average level and most of the candidates got confused with components of internal control system as per COSO, according to which control environment is just one component of control system.

Following are some of the irrelevant answers provided by the candidates:

- Control of employees.
  - Corporate governance.
  - Business process and procedures.
- (d) This part requested to explain three business processes required for **Osu Medura (Pvt) Ltd.** Majority attempted the question and performance were at an average level. Many candidates had mentioned business processes without explanation and earned lower marks. Though this question is easy some does not know basics of the topic.

Some candidates had provided irrelevant answers such as:

- Manufacturing process.
  - Sales and Marketing process.
  - Administration process.
- (e) Requested to identify three application controls with an example each, that **Osu Medura** can consider. Majority did not attempt the question and performance was at a very poor level. Very few candidates had mentioned valid example for each control. Candidates are advised to improve their knowledge on following areas. These areas have been clearly mentioned in the study text.
- Risks associated with the use of computerized systems.
  - IT general controls with examples.
  - IT application controls with examples.
  - Importance of IT controls.

### **Question No. 09**

- (a) Requested to explain three types of audit procedures other than calling for external confirmations to obtain audit evidences. Performance was at an average level. Some candidates had repeated “calling for external confirmations” due to poor understanding of the question. Most of the candidates had mentioned types of audit procedures but not explained.
- (b) This part of the question requested to explain what is meant by negative confirmation request. Most unsuccessful candidates had explained the meaning of external confirmation rather than negative confirmation request. Some of other irrelevant answers provided by candidates are confirmation without detailed information, confirmation given when confirming party unable to settle liability, etc.

- (c) This part of the question requested to identify two analytical procedures that can be carried out by the auditor in comparison of TPLC financial information. Performance was at below average level. Some candidates had provided totally irrelevant answers such as; Analysis of going concern, Test of controls, Substantive procedures, etc.
- (d) This part requested to identify five events and conditions that may cast doubt about the going concern assumption. Almost all the candidates attempted this part and scored satisfactory marks. The details given in the question also includes many conditions and events about the going concern assumption. The study text also describes number of events and conditions relating to going concern.
- (e) This part requested to assess the request made by the company, considering the requirements relating to emphasis of a matter paragraph. Without understanding what is the emphasis of matter paragraph candidates have given the answer. Only a fewer number of candidates attempted the question and performance was very poor. Some candidates had mentioned Emphasis of matter paragraph can be used although auditor has decided going concern assumption is not appropriate. Handful of candidates stated that opinion needs to be qualified.
- (f) This part of the question requested to explain the suitability or non-suitability of issuing a qualified opinion **TPLC's** financial statements. This part was attempted by lesser number of candidates and performance was very poor. Some candidates had mentioned that qualified opinion can be issued. Most of the candidates who attempted had considered the impact of misstatement as material but ignore the pervasiveness. Therefore, a fewer number of candidates mentioned that adverse opinion should be given since the matter giving rise to the modification both material and pervasive.

Candidates are advised to have knowledge on following subject area:

- Financial and operating indicators for going concern.
- Management responsibility for going concern.
- Audit procedures for going concern reviews.
- Auditor's reporting (more important)
- Communication with those charged with governance.

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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 paper 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 examination 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.