

Examiner's Report

AA3 EXAMINATION - JANUARY 2019

(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.

Most of the questions contained in the question paper were 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 lack practice as to how the answers should be formulated based on the subject matter.

The Overall Performance of the candidates for this paper was not that satisfactory, and there were only few 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 external environment affecting the business of leading software development company. The first part of the question is straightforward and requested candidates to identify the two key forces of the external environment. Second part of the question was to test the ability of candidates to justify the identified key factors under first part.

Majority of candidates have understood the requirement and answered correctly and earn full marks. Therefore the overall performance of the question was at a satisfactory level. However there were candidates who were unable to obtain marks, as those answers were not related to the question and some of them were given very general type of answers which were not related to the requirement of the question.

Eg : Telecommunication, Eco friendly environment, Transportation etc.

Question No. 02 (Marks Allocated 05)

This question was to test the knowledge on financial statement assertions that are relevant for Property, Plant and Equipment. Overall Performance of this question was average, and a few candidates were able to secure full marks.

Some of the candidates have answered with lengthy paragraphs which are not relevant for the given question. Also some of the candidates have discussed only one assertion such as "completeness" throughout the full answer and therefore it is evident that the awareness relating to financial statements assertions is at a very poor level.

Question No. 03 (Marks Allocated 05)

Part (a) of the question was to test the knowledge of candidates regarding the persons who may not be appointed or act as an auditor of a company and in the second part of the question, the examiner tested the procedures to be carried out by the auditor before accepting a new appointment.

The question was very straightforward and direct answers could have been given. For the **part (a)** considerable number of candidates has given the correct answer and therefore the performance was at an average level. **Part (b)** was very poorly answered by majority of the candidates and the performances were at very poor level. Most of the candidates who have attempted **part (b)** of the question misunderstood and written common wrong answers such as terms of engagement letter and some of the candidates have written steps of appointing an Auditor at the Annual General Meeting (AGM), etc.

Question No. 04 (Marks Allocates 05)

Under the **part (a)** of the question, the candidates were required to explain what is meant by **misappropriation of assets**.

Some of the answers were very narrow and just mentioned the theft to assets, which was not satisfactory enough to get full marks allocated. Also most of the candidates used the words misuse and personal gain rather than theft. The examiner expected to test only one type of fraud.

Under the **part (b)** of the question, candidates were required to identify two conditions / events that increase the risk of fraud at **Roma Ltd**. The overall performance was satisfactory. Except few, all other candidates gained full marks. Candidates who reproduced the given facts in the scenario also obtained full marks even though not having proper subject knowledge on conditions or events which increase the risk of fraud or error.

Section B

Three (03) Compulsory Questions

Question No. 05 (Marks Allocated 10)

Part (a) of the question, tested theoretical knowledge related to Assurance engagement. Majority of the candidates had successfully answered this part and they were able to score full marks by correctly explaining what an assurance engagement is.

Part (b) of the question was to test the ability of the candidates to identify the practical world examples for Assurance engagements. Considerable number of candidates have answered using general examples and the overall performances were at an average level. The general words, the candidates have given were the Stocks, Debtors, Employees, etc.

From **Part (c)** of the question, the examiner tested the type of assurance engagement the auditor would be performed on **Sectos Ltd.'s** financial forecast. Most of the candidates had ignored answering this part and the candidates who answered also were unable to identify the difference between reasonable and limited assurance. Most of the candidates have given it as a reasonable assurance engagement. Therefore the overall performance for this part was at a very poor level.

Question No. 06 (Marks Allocated 10)

From **Part (i)** under **part (a)** of the question, the examiner expected candidates to differentiate the audit procedures for inspection from observation. This was a technical question and examiner expected candidates to differentiate the two audit procedures in obtaining audit evidence in accordance with Sri Lanka Auditing Standards.

The overall performance for this question was at a very low level and therefore, very low marks had been earned.

Some of the common mistakes the examiner has identified are as follows:

- Some candidates have given the definition of inspection to observation.
- Some have explained inspection as examination of audit procedures.
- Examination of audited financial statements.
- Preparation of Accounts one by one.

Part (ii) under **part (a)** of the question, the examiner has requested candidates to identify the audit procedures to perform on bank reconciliation statement. This is a practical type of question and candidates were able to answer by using their practical audit experience along with the theoretical knowledge.

Majority of the candidates have attempted only a part of the question. Only a very few candidates managed to get the full marks. Most of the candidates had no idea on auditing bank reconciliations and they just mentioned the audit procedures as follows;

- Inspection.
- Observation.
- Inquiry.
- Re-computation.
- Investigation.

Part (b) of the question was to test the knowledge of the candidates in applying the audit procedures to audit the Pre-Paid Rent Expenses. Most of the candidates have not properly planned with the requirement by referring to the given scenario. Therefore the performance for this question was at an average level.

The common erroneous answers the examiner has identified were:

- Ensure whether the quotations are called.
- Correctness of Pre-Payments.
- Inspection & Observation of Pre-Payments.
- Correctness of Pre-Payments.

Question No. 07 (Marks Allocated 10)

Part (i) under **(a)** of the question is relevant to External confirmations. Majority of the candidates have successfully scored full marks for this part. The performance was at a very satisfactory level.

Part (ii) under **(a)** was to test the actions that can be taken by the auditor if the management refused to allow the auditor to send the confirmation request. Majority of the candidates have attempted this part of the question and the performance was at an average level.

The common incorrect answers given by the candidates were as follows:

- Getting required information from external parties – (General).
- Acting as per the engagement letter.
- Taking legal action against the management.

Part (b) of the question was to test the points that should be included in the audit engagement letter. In this respect the candidates' practical and theoretical knowledge were at a very poor level. As some of the answers for the matters to be incorporated in an employment agreement, Designation of Auditor, Relevant section, the time period, the consent of the management. The overall performance to this section was at average level.

Section C

Two (02) compulsory questions only

Question No. 08 (Marks allocated 25)

In this question, the examiner has given a case study, and two questions based on the theoretical knowledge from Risk Management framework and IT general control along with the application controls.

Part A

This part of the question, was to test the knowledge of candidates regarding the steps of risk management framework. This is a theory based question where detailed answers could have been given. Considerable number of candidates have given the facts, but not provided clear detail explanations. The performance was at an average level.

The irrelevant common answers were, Eg: Control risk, Deduction risk, High risk.

Part B

This part was answered by majority of the candidates and the performances were at a very high level as the details were to be extracted from the case study itself.

Part C

The examiner tested the knowledge on IT General controls and application controls in an information technology controls. This was to check the theoretical knowledge about the General controls and application controls in an IT environment.

Most of the candidates who attempted this part had totally misunderstood and most of them had written general answers such as limited access or authorized personnel only, physical security for both general controls and application controls, etc. Some of the candidates have written answers of general controls for application controls.

The overall performance of the candidates was at an average level for this part of the question.

Question No. 09 (Marks Allocated 25)

Part A (a)

Candidates were required to state five matters that need to be considered in forming the auditor's opinion on financial statements of an entity.

Those who studied the study text wrote relevant answers and obtained full marks allotted to this part. There were some candidates who misunderstood the question requirement and wrote facts relevant to "Beta shoes" company.

Eg: Recoverability of insurance claim:

- Ability to complete the restoration of the destroyed building.
- Appropriateness of going concern basis used, etc.

Among unsuccessful answers following incorrect / irrelevant answers were noted:

Some candidates provided elements of assurance engagements.

(Three party relationship, subject matter, suitable criteria, evidence and assurance report)

Part A (b)

Candidates were required to assess whether there are any other implications to the Auditor's report of the financial statements of Beta Shoes for the period ended 30th September 2018. The examiner expected to test the knowledge on audit reporting when going concern issue is existing. Accordingly the examiner expected them to identify whether it is appropriate for the given scenario to be taken as "Going Concern assumption when there is a material uncertainty which was adequately disclosed." But majority of the candidates failed to understand and correctly assess the impact on auditor's report as unmodified opinion with emphasis of matter paragraph.

However, there were candidates, without proper understanding of the question, wrote following irrelevant parts pertaining to going concern assumption and failed to obtain marks:

- Management responsibility for going concerns assumption.
- Management's assessment of the going concern assumption.
- Audit procedures applied in performing going concern review.

Part B

Candidates were required to identify two examples for self-interest threat, self-review threat and advocacy threat. Many candidates who gained proper subject knowledge answered this part correctly. Some provided explanation for each threat in addition to examples. Also most of the unsuccessful candidates mixed up self-review threat and advocacy threat and some of the candidates identified fundamental principles set out in the code of ethics for professional accountants. Overall performance for this part was at a satisfactory level.

Part C (a)

Candidates were required to explain the steps that **S & S** would need to perform with respect to acceptance of the additional engagement as the tax consultant of **Hunt Ltd**. The examiner expected to test steps in code of ethics in relation to fundamental principles and conceptual framework. However a very few candidates answered correctly. Most of the candidates answered as agreeing to terms of engagement by signing a separate engagement letter. Common mistakes identified in the answers were:

- Some candidates attempted to explain some steps from the Hunt Ltd side.
- Some others explained regarding income tax calculations after acceptance of assignment (Obtain information, consider allowable and disallowable expenses, calculate taxable income, apply appropriate tax rate, etc.)

Part C (b)

Candidates were required to explain the element of “Acceptance and continuance of client relationships” if S & S has established a system of Quality Control within their firm. The examiner expected to test one of the elements in quality control system. Except for few candidates who gained proper subject knowledge others provided very general answers by considering the word “quality”. Following were noted commonly.

There were candidates without proper understanding of the question, who wrote about the quality control requirements for an audit of financial statements, such as direction, supervision, review and failed to earn marks.

Overall performance of the question was not very satisfactory and majority of the candidates obtained between 30% - 40% out of 25 marks allotted for this part.

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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.