

Examiner's Report

AA3 EXAMINATION - JULY 2017

(AA34) PROCESSES, CONTROLS AND AUDIT

General Comments

Processes, Controls, and Audit (AA34) included nine (9) compulsory questions based on the study text. There were three (3) sections; **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 the study text and have tested the theoretical knowledge of the candidates and its application in a practical environment. If candidates have thoroughly gone through the study text and have done past paper questions of its application in a practical environment, easily candidates could have reached the pass marks for this paper.

Performance of the candidates was at a fairly satisfactory level. There were significant number of candidates who have secured high marks and which indicated the fact that those candidates have studied and understood the theoretical knowledge given in the study text and its application in a real auditing and business environment. Further, there were considerable number of candidates who obtained low marks. We noted, based on their answers, they have not studied the study text, and not done past paper questions. If they have done so, they would have easily gained more than 50 marks.

Majority of candidates have attempted and answered all questions in the paper, however, we noted that there were some parts of the questions not answered. We believe those unanswered questions were not done mainly due to poor time management, lack of knowledge, or poor examination techniques etc. 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.
- Identified the issues in the case, however, not given answers in line with the questions.
- Not planning the answers and ending up with providing irrelevant answers.
- Not following the “**Action Verb**” given at the end of the question paper.
- Not understood the examiner’s expectation.

Section A

Four (04) Compulsory Questions

Question No. 01 (Marks Allocated 05)

This question consisted two parts, part A tested the knowledge of objective of starting up a business at the initial stage of operation and after lapse of one year, and Part B tested the understanding of social and cultural factors affecting the business.

The overall performance of the question was satisfactory. There were significant number of candidates who have obtained full marks for the question.

However, several candidates were unable to secure mark for this question, as the answers given by them were not relevant for the question. Examples of irrelevant answers given in **Part A (a)** were profit maximizing, recover the investment, providing food at low cost, identify competition between businesses, understand the demand of consumer product, increase the sales of business, cash management, introduce new product to the market etc.

In Part A (b), there were irrelevant answers given such as convert business into limited liability company, waste & garbage management, increase investment in capital, survival, promotional campaign, search for new product, maintaining good relationship with students etc.

Part B, some candidates have not got a knowledge as to what are the social and cultural factors affecting a business, and thus have given irrelevant answers such as decrease interest in fast-food, parent not allowing children to buy fast-food, health concern of food, business located close to tuition class, impact from government laws and regulation etc.

Question No. 02 (Marks Allocated 05)

This question consisted of two parts. **Part A** tested the knowledge of two (2) methods of mitigating risks and **Part B** tested the understanding of three (3) risk reduction methods.

Overall Performance of this question was satisfactory, and majority of candidates secured full marks. However, candidates who have given irrelevant answers for **Part A** such as fraud risk, control risk, explaining risk, accessing the risk, response to assessed risk, establishing approval limits, having negative risk, situational risk, identifying risk before it is happening, risk in transactions, risk in evaluating etc.

For **Part B**, there were irrelevant answers given such as how to mitigate audit risk, identification of risk assessment in audit, risk control, authorizing payments by finance executive, preparation of financial statement by auditor to avoid risk, analyzing the problem, taking action before risk happening, preparing balance reconciliation to reduce risk etc.

Question No. 03 (Marks Allocated 05)

There were two parts consisted in this question. **Part A** tested the knowledge of the candidates on the term “Professional Skepticism” and **Part B** tested the understanding of the candidates on the three areas of an audit, where auditor should apply professional judgment.

Part A- Overall performance was at an average level. Significant number of candidates were able to secure high marks for **Part A**, however there were irrelevant answers given such as “Professional Skepticism is working with integrity, independence, objectivity, confidentiality, and competence, “Professional Skepticism is working with professional judgment”, identifying audit evidence, professional behavior of the auditor, plan and perform to obtain appropriate and sufficient audit evidence etc.

Part B- overall performance for this part of the question was not satisfactory and only a few candidates were able to obtain full marks. There were irrelevant answers such as the professional judgment to be used in Fixed Assets verification, finance field, management field, operational field, Internal Audit, Statutory audit, Certification, quality control, risk management, professional competence etc.

Question No. 04 (Marks Allocates 05)

Part A, tested the objective of the quality control policies and procedures to be adopted by an audit firm, and, **Part B**, tested understanding of three (3) matters to be ensured by a senior member when reviewing the work of a more junior member.

The performance for this question was very poor. A very few candidates managed to get full marks and significant number of candidates were not able to obtain marks for this questions.

There were significant number of irrelevant answers for **Part A**, such as increase the efficiency of business operation, issuing an audit report that can easily understandable, to have experience qualified auditors to provide good opinion, train audit staff to avoid material misstatements, control the mistakes of audit assistants, improve the ability of audit assistants to be used for audits and assignment, ensure the quality of the internal controls, ensure the effectiveness and efficiency of the control etc.

Under **Part B**, there were many irrelevant answers such as ensure that the audit report is true and fair, compliance with rules, regulation and code of ethics, give respect to junior staff, understanding each auditors work, senior should compare the audit evidence with audit junior’s work, check the confidentiality of the audit juniors, ensure that the audit was done in accordance with Sri Lanka auditing and accounting standards etc.

Section B

Three (03) Compulsory Questions

Question No. 05 (Marks Allocated 10)

Part A, the candidates were required to explain as to what an assurance engagement is and the performance for this part was at an average level. There were candidates who secured full marks, however, there were candidates who could not understand the meaning of assurance engagement as such they have given wrong answers such as Assurance engagement is done to increase the quality of the opinion, providing an opinion on past performance of firm or company, providing an opinion on special purpose financial statements, providing assurance on environment matters, engagement to provide assurance for taking bank loan etc.

Part B required to identify as to what type of audit engagement that the audit firm should undertake based on the facts given in the mini case study. The performance for this part of the question was not satisfactory as majority of the candidates were not able to identify the difference between reasonable and limited assurance as such those candidates have given reasonable assurance as the answer where the examiner's expected answers was limited assurance, thus no marks awarded for such wrong answers. There were a lot of irrelevant answers such as internal audit, operational audit, financial audit, related service engagement without specifying the types of the engagements based on the requirements given in the case.

Question No. 06 (Marks Allocated 10)

Part A, tested to identify four (4) ways in which it increases the reliability of audit evidence when gathering audit evidences. There were a handful of candidates who managed to obtain high marks, while majority of candidates secured average marks. There were number of irrelevant answers such as collecting information from financial statements, use professional skepticism and judgment to collect evidence, increase the sample size and spent more time to get more audit evidence, checking more risk areas, comply with ethical requirements etc.

Part B tested the application knowledge of the candidates to obtain audit evidences on increased lease rentals based on the facts given in the mini case study. It was noted from the answers that candidates' knowledge on this area were very poor and most of them were unable to understand the question and not able to secure marks for this part of the question. There were considerable number of candidates who could not secure marks due to providing of wrong answers such as obtaining evidence from financial statements, observation of building, use analytical procedure without explaining as to how it should be done, general answers such as test of details, substantive procedures, correctly applying accounting standards, inquiring from legal officer etc.

Question No. 07 (Marks Allocated 10)

Part A, tested the knowledge on management responsibilities on related party transactions and balances. The performance was very poor. Only a handful of candidates provided accurate answers for which high marks were awarded. Number of wrong and irrelevant answers such as management is responsible to have legal transactions between related parties, providing all information in proper way, preparing financial statements on time, providing all information

required for the audit on time, communicating all related party transactions to the relevant parties etc, have been provided by number of candidates.

Part B tested the knowledge on five (5) audit procedures to identify related party transactions. The performance for this part of the question was very poor. Candidates could have easily obtained full marks for this part, if they have studied this area properly. Only a handful of candidates could secure full marks, while majority could not able to obtain marks due to providing of wrong answers such as auditor has to collect sufficient and appropriate audit evidence without explaining as to how it should be done, just mentioning checking Goods Received Notes without relating to related party transactions, general terms such as test of control, substantive procedures, without explaining as to how those should be used to audit the related party transactions, questioning the related parties, checking that the related parties have acted in good faith etc.

Part C tested the knowledge on the purpose of getting a management representation for related party transactions and balances. The performance was very poor. Number of irrelevant answers such as management has to give good opinion on related party transaction, management has to give the management representation to auditors to check the related party transactions, management has to give a letter confirming that they will give the auditor full support during the auditing process, information of savings and current accounts with related parties etc, were given by majority of candidates.

Section C

Two (02) compulsory questions only

Question No. 08 (Marks allocated 25)

Part A

Part (a), this question was based on a case study. It was required to identify three (3) important matters to be included in the Material Requisition Note (MRN). This was a very easy question. The performance for this question was above the average and most of the candidates could secure full marks for this part of the question, however, there were candidates who could not obtain marks for this question, due to irrelevant answers such as quality of raw material, number of items produced, cost of the items purchased, unit value, quality, available quantity in the stores etc.,

Part (b)-(i), the audit procedure to ensure that “Production orders are issued based on the Customer orders”, have been tested. This was a very easy question. However, majority of the candidates were not able to get marks due to providing of irrelevant answers such as check profitability of the order, check reject orders, check signatures, getting confirmations from customers for the quantity ordered, customers order should be checked before it is dispatched.

Part (b) –(ii), the audit procedure to ensure that “Material requisition note is issued only if valid production order is available” was tested. Irrelevant answers such as reduce wastage in the process, checking signatures, checking customer orders, production order, inspection of production orders to confirm that orders have been completed, general statements such as corrective control, authorization, inquiring management without relating to the question etc., were given by number of candidates.

Part (b)-(iii), the audit procedures to ensure that “matching of material issues with material requisitions” were tested. Number of irrelevant answers such as checking orders, checking signatures, detective control without explaining as to how it should be related to the question, re-calculation and re-performance without indicating how those should be done, compare with bin card without mentioning with what, etc were given by number of candidates.

Part (b)-(iv), the audit procedure to ensure that “three-way matching is performed by FG store executive” were tested. Number of irrelevant answers such as prevents storing unnecessary items in the stores, check efficiency in the production process, general answers such as test of details, detective control, observations, re-calculating etc were given by number of candidates.

Part (b)-(v), the audit procedure to ensure the “control performed by sales department” was tested. The performance for this part of the question was very poor. Number of irrelevant answers such as avoid selling of extra stocks, over valuation of stocks, inquiring the cost of raw material used, check the reliability and accuracy of the work done etc were given by number of candidates.

Part (c), tested three (3) audit procedures that the auditor should perform to obtain an understanding of the entity and its environment. The performance for this part of the question was above the average. However, there were candidates who could not able to secure marks due to providing of wrong answers such as calling confirmations from debtors/creditors, auditor should work closely with the entity, reduce risk of the entity, submit audit report on time etc.

Part (d) tested three (3) financial statement assertions that need to be addressed in testing sales of the given company. The performance was above the average. There were considerable numbers of candidates who have obtained full marks for this part of the question. However, some other candidates were not able to secure marks due to considering comparability and inspection also as financial statement assertions. Moreover, irrelevant answers such as checking sales invoices, debtors, revenue, statement of financial position, changes in equity, statement of cash flows etc. were mentioned by number of candidates.

Part B

Part (B)-(a) This question required candidates to mention two (2) examples for IT General Controls in Developing a computer application. The performance for this question was very poor. Only a handful of candidates obtained full marks and majority of the candidates were not able to secure marks due to providing of wrong answers such as obtaining copy rights, using excel, obtaining licenses, obtaining anti-virus, automatic calculation etc.

Part (B)-(b) This question required candidates to mention two (2) examples of IT General Controls to prevent unauthorized amendments to data files. Majority of the candidates were not able to secure marks for this question due to providing of irrelevant answers such as segregation of duties, fixing cameras, main server and computers should be kept in a lockable room, using virus guards, backups and storing in pen drive or hard disks, activation of software etc.

Part (B)- (c)- It was required to mention two (2) examples of IT General Controls to ensure continuity of operation. Only a very few candidates obtained full marks and majority of the candidates have not obtained marks for this part of the question due to providing wrong answers such as updating computers, computerizing all manual systems, password protection, applying new applications and operating systems, giving separate passwords to user etc.

Part (B)-(d) It was required to mention IT General Controls to prevent or detect unauthorized changes to programme. The performance was satisfactory. However, there were candidates who could not obtain marks due to providing of wrong answers such as firewalls, obtaining licenses, updating computer systems, computerizing the manual systems, checking the reasonableness, checking the other application, installing new version etc.

Question No. 09 (Marks Allocated 25)

Part A

Part A –(a), tested three (3) audit procedures that the auditor should perform to verify Property, Plant, and Equipment. The performance of this question was above the average. Some of the candidates have successfully answered to obtain full marks, however, there were number of wrong answers such as analyzing disclosures in the financial statements, use test of control, use accounting standards, use substantive procedures to check fixed assets, analyze and review fixed assets etc.

Part A-(b), tested the difference between test of controls and substantive procedures. Majority of the candidates were not able to give satisfactory answers and therefore obtained low marks. Only a handful of candidates were able to provide good answers to obtain full marks. However, there were candidates who could not secure marks due to explaining test of controls as control to prevent fraud and errors, it is about internal controls, collection of information, detection and correction of matters etc and substantive procedure as minimizing frauds, confirmation of fraud and errors, legal requirements, third party confirmations, overall analyzing of matters and confirmation of an activity etc.

Part B

Part B (a), it was required to identify the audit opinion on the financial statements based on the facts and figures given in the case study and to the difference between capital and revenue expenditure. Most of the candidates were unable to identify the differences between the capital and revenue expenditure. Further, they were unable to understand the meaning of materiality. It was required to identify the renovation cost of Rs.2,500,000/- as a revenue expenditure. However, some candidates have not identified it. The performance for this question was not satisfactory. Some candidates have mentioned that emphasis of matter should be given if it had not been adjusted, some other candidates have mentioned that the auditor needs to prepare financial statements etc.

Part B (b), tested three (3) elements of an auditor's report other than auditor's opinion paragraph. This was a very easy question. The performance for this question was good and significant numbers of candidates have obtained full marks for this part of the question. However, number of irrelevant answers such as audit evidence, audit working papers, scope of

the audit, audit fees, way of collecting evidence etc. were given by considerable number of candidates.

Part C

Part C (a), it was required to mention two (2) threats to compliance with the fundamental principles based on the details given in the case study. The performance for this part of the question was at an average level. There were few candidates who have provided complete answers to get full marks. However, wrong answers such as financial threats, agreement with work opportunities, professional behavior and independence, dispute with management etc., were also mentioned by majority of the candidates.

Part C (b), tested the fundamental principles of Objectivity, Professional Competence and professional behavior that the members of AAT Sri Lanka must comply with. This was a theoretical question and candidates could have answered using the knowledge of code of ethics of AAT -Sri Lanka. Almost all the candidates have attempted the question and able to obtain satisfactory marks. Some candidates have mentioned objectivity as providing good output, knowledge about subject matter, give fair opinion timely, preparation of accounts with clear understanding etc. They have mentioned competence as having ability to compete with other professionals, trustworthiness, honesty, due care, compete with others etc. The candidates have identified professional behavior as proper behavior, competency to do work, having business mind, good manners, leadership quality, self-confidence, etc..

- - -

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.