

Examiner's report

Foundations in Audit (FAU)

December 2011



General Comments

The examination paper comprised two sections. Section A (worth 20 marks) contained 10 multi-choice questions, each worth two marks, on topical areas from across the examination syllabus. Section B (worth 80 marks) contained four compulsory questions, two of which were worth 25 marks each with the other two being worth 15 marks each. This is the final session of exams for which the paper will be formatted in this way.

A significant majority of candidates answered Section A to a satisfactory standard, by answering at least five of the ten questions correctly. A number of these candidates scored very highly - by answering at least eight of the questions correctly. As one might expect there was a strong correlation between marks achieved in Section A and Section B by individual candidates, with strong or weak performance in one being reflected by strong or weak performance in the other. A number of candidates performed to a satisfactory standard, however a sizeable minority performed inadequately in both Sections, with their overall mark falling a long way short. In general, the reason for inadequate performance is inadequate learning technique combined with a lack of satisfactory exam technique. This was particularly apparent for Section B where many answers submitted were of an extremely poor standard – often being far too brief, containing irrelevant points, being muddled or totally incorrect. Again, it seems that a very significant number of candidates were not properly prepared for the exam.

Virtually all candidates attempted all of the questions in Section A. Most attempted all questions in Section B, with some answering in the order set and others seemingly answering in order of 'easiest' to 'hardest' questions as seen by them. It was noted that candidates who adopted the latter strategy often achieved a satisfactory mark for Section B - indicating use of sound exam technique. In Section B, in terms of marks achieved, candidates found question two to be the most challenging followed by questions four, one and three in that order. It is of some concern that a sizeable number encountered particular difficulty with question two given that it tested knowledge of core areas of the syllabus.

Reiterating previous comments made - this paper is set at a level which is testing but 'very passable' for those that are reasonably well prepared. The main reason for a candidate achieving a low mark is simply due to lack of proper preparation. The key to success is similar to that for any examination. Namely, a timely and structured approach to a course of study, ensuring that sufficient emphasis is placed on revision, question practice and examination technique.

Specific Comments

Question One

The majority of candidates answered this section to a satisfactory standard. However a significant minority submitted correct answers to only a few of the questions. In line with previous sessions the questions tested candidates' knowledge across the range of topics included in the syllabus and an in-depth knowledge of these is required if candidates are to ensure a satisfactory mark for the Section. Candidates are reminded that the best technique to adopt when answering Section A questions is to work through them methodically in order, leaving any questions out which you are unsure and return to them after you have attempted the later questions in the Section.

Section B

Question One

For a total of 25 marks over five parts, the question tested knowledge about internal control, control activities, auditor objectivity and the audit of tangible non-current assets.

At part (a) candidates were required to state five objectives that should be exercised over tangible non-current assets. In my examiner's reports for previous sessions, I have frequently mentioned that candidates do not appear to know the difference between 'control objectives' and 'control activities' - often muddling the two. Regrettably a sizeable minority of candidates at this sitting indicated that they do not know the difference, with many providing a list of five 'examples of control objectives' - all, or the majority, of which were in fact control activities. It was noticeable that relatively few candidates were able to state five control objectives and therefore obtain all of the five marks available for this part of the question.

Part (b) offered two marks for defining the term 'control activities'. Only a minority of candidates seemed to appreciate that for two marks they would be expected to write only a succinct definition, for example, "Control activities are the policies and procedures that help ensure that management directives are carried out" (as contained in ISA 315) - or similar. A relatively large number submitted long explanations of the term - many of which were wholly inaccurate, whilst others were just plainly wrong and were not awarded any of the marks available.

Part (c) asked for descriptions of six control activities that should be established over tangible non-current assets by the subject company. A significant number of candidates provided satisfactory answers here, but a large minority did not - with some confusing control activities with control objectives and others providing examples of audit substantive procedures.

I have previously flagged my continuing concern that many candidates display weak and disjointed knowledge in the areas of internal control *objectives* and control activities. Despite this, and the inclusion of articles on these topics in student accountant, generally, candidates' exam performance in these topical areas continues to be unsatisfactory.

Part (d) tested candidates knowledge on the self-review threat to an auditor's objectivity involved in the design of an improved internal control system. Few candidates obtained all of the three marks available with many obtaining only one mark or less by adding very little, if anything, to the point mentioned in the requirement that the auditor's involvement *would* represent a threat. A small minority of candidates clearly did not understand as to the meaning of the term "self review" - this was of particular concern.

The use of an assets register plays an important part in the control and audit of tangible non-current assets, and the six mark requirement at part (e) tested candidates' knowledge of these. Most candidates were able to list six pieces of information that should be included in the register for each individual asset (for example, date of purchase or disposal, cost, depreciation method), to obtain the full three marks for the first part of the question. Conversely, in the second part, few seemed to be aware as to how the register should be used by the auditor to verify both the 'existence' and 'completion' assertions.

Question Two

The total mark available for the question was 25, over four discrete parts.

Part (a) required candidates to identify and explain four matters, each for two marks, to be considered in the course of carrying out client screening procedures in respect of a potential audit client company. Candidates were specifically requested *not* to refer to the need to communicate with the company's previous auditor, however a significant number did - obtaining no marks for commenting on this specific issue. A relatively high number included specific planning issues in their answers - and again were not awarded marks for these. There is clear demarcation between 'screening' and 'planning' matters,, and the fact that so many candidates were unclear as to the distinguishing features of each suggests that additional learning time needs to be focused on these areas. Some of the most important screening considerations relate specifically to ethical matters, for example, threats to the auditor's objectivity (independence) and management integrity – but only a relative few candidates actually referred to 'ethical' issues, therefore losing the opportunity to obtain marks available for this.

At part (b) (i) a majority of candidates scored at least half of the five marks available for explaining the reason that staffing issues would represent an important part of the planning process of the audit of the subject company. However, reflecting the apparent general weakness of candidates at this level to competently answer questions specifically about the audit of computer – based accounting systems, a large number of candidates were unable to provide anything more than an unsatisfactory to (b) (ii) - to explain why the existence of such a system would need to be considered at the audit planning stage. Candidates reviewing the model answers to the part (b) requirements may note that they each extend to more than 150 words. Whilst there is no real expectation for answers submitted to be so comprehensive, generally for a five mark requirement candidates cannot realistically expect to obtain anything more than one or two marks when their answers are very short.

Part (c) of the question was answered to an unsatisfactory standard by a significantly high number of candidates, which was unexpected given that the subject matter (ICQs and ICEQs) are important topics. For five marks there was a requirement to explain the purpose of each and clearly distinguish between the two. From the answers submitted it is apparent that a very large minority of candidates have only very superficial knowledge as to the use of these, in that they appreciate both are used by the auditor at the 'ascertaining, recording and evaluation of the systems' stage of an audit – but do not know how they are actually used by auditors. A lot of answers amounted to little more than stating assertions that ICQs are used to record systems whilst ICEQs are use to evaluate systems. A minority confused the use of each by asserting that the former is used to 'evaluate' and the latter is used to 'record' (systems).

The purpose of part (d), for two marks, was to test candidates ability to identify the inherent risk factors presented in the financial statements of a retail company with a wide geographical spread of stores. Many candidates were not able to do this and did not score any of the two marks. A majority obtained just one mark or less because they were clearly confused as to what is meant by inherent risk as compared to control risk and detection risk. This is unsatisfactory given that auditors must adopt the risk based approach when carrying out an audit engagement.

Question Three

The question tested candidates' knowledge of the sufficiency and appropriateness of audit evidence and whilst there were some sound answers submitted, there were also some inadequate and incorrect answers which scored very low marks. A total of fifteen marks were available over three parts.

Part (a) offered three marks for accurate definitions of the terms 'sufficiency' and 'appropriateness' of audit evidence. A relatively high number of candidates obtained all three of the marks available, but the large majority offered rather imprecise definitions and obtained less marks.

ISA 500 sets out the various generalisations about the reliability of audit evidence. One of these was provided as an example in the lead up to the requirement at part (b), which required candidates to state three (of the four) other generalisations. Two marks were available for each one correctly stated. A high number of candidates correctly stated three of the other generalisations, however some wasted time and effort by stating all four. Conversely some candidates wasted time and effort by simply including the example generalisation provided in the question along with two others. Unfortunately many candidates did not score any of the six marks available.

The standard of answers submitted to part (c) for six marks were mixed. The question required two practical examples of documents prepared outside the company, two documents prepared inside the company and two examples of recalculations performed by the auditor. As included in the model answer - a purchase invoice is an example of a document prepared outside the company and a purchase order is an example of a document prepared inside the company. Similarly when auditors check the arithmetical accuracy of a purchase invoice or of depreciation calculations they do this by 'recalculating'. A significant minority of candidates ignored the requirements of the question or were unjustifiably confused by it. This was evidenced by the fact that they named audit working papers and other incorrect papers as documents prepared inside or outside of the company, and were of the opinion that reperformance procedures carried out by auditors (such as checking the quantities counted at an inventory count) are in fact recalculation procedures.

Question Four

The question was in two distinct parts with each examining each different parts of the syllabus – 'auditor's expert' and audit working papers. Fifteen marks were available in total.

At part (a) (i) the requirement was to identify four fields in which an auditor's expert may have expertise. Most candidates managed to identify at least two fields - the most popular two being in the valuation of land and buildings and in the valuation of specialist plant and machinery. A high number of candidates clearly did not have a proper appreciation of why auditors employ their own experts and proceeded to identify fields of expertise which have no discernible relevance to the inherent risks presented in a set of financial statements. No marks were awarded for these. Part (a) (ii) required candidates to identify four sources from which information regarding the competence, capabilities and objectivity of an auditor's expert may be obtained. This caused few problems for reasonably well prepared candidates - this fact being reflected in the marks awarded for the part.

Part (b) (i) offered four marks for stating four factors other than 'the size and complexity' of the company, on which the form of audit documentation (working papers) depend. The standard of answers submitted was in the main unsatisfactory with very few candidates managing to identify four relevant factors such as the nature of the audit procedures to be performed, the identified risks of material misstatement and the audit methodology and tools used (for example, CAATs). Part (b) (ii) for three marks, tested understanding of the quite differing functions of a 'hot review' and a 'cold review' of audit documentation. It was apparent that whilst a significant number of candidates did appreciate that the former is carried out prior to the signing of the auditor's report and the latter is carried out after, the vast majority have only a very superficial knowledge of what each review actually entails and the purpose of them.