RELEVANT TO ACCA QUALIFICATION PAPER P7

Syllabus and Study Guide update

The purpose of this article is to highlight a few changes to the *Syllabus* and *Study Guide* for Paper P7, affecting the June 2012 exams onwards.
I start by pointing out that at this time there is no major change to the Paper P7 *Syllabus* and *Study Guide*, and that the 2012 *Syllabus* and *Study Guide* contains a table which shows the small number of amendments that have been made. This article will briefly outline some of these amendments.

Risk of material misstatement
An important part of the Paper P7 syllabus is risk assessment in the context of planning an audit of financial statements. To bring the syllabus into line with ISA definitions and requirements, the wording of learning outcome D1(i) d) has been amended from 'Identify and explain financial statement risks for a given assignment', to 'Identify and explain risks of material misstatement for a given assignment'".

Material misstatement is defined as the risk that the financial statements are materially misstated prior to audit, and consists of two components – inherent risk and control risk – which are two components of the audit risk model, the third being detection risk. Candidates are therefore advised that when answering a requirement based on the risk of material misstatement they should focus their answer on inherent risk and control risk factors only. Detection risk is not part of the risk of material misstatement.

Business risk is broader than the risk of material misstatement of the financial statements. According to ISA 315, *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment*, an understanding of the business risks facing the entity increases the likelihood of identifying risks of material misstatement, since most business risks will eventually have financial consequences and, therefore, an effect on the financial statements. As such, business risk can help to identify a risk of material misstatement but business risk itself is not a risk of material misstatement. Candidates are advised that including a business risk in an answer where the requirement is to do with risk of material misstatement will not earn credit unless the business risk is developed into a specific risk of material misstatement in the financial statements.

A significant risk is defined as an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration. Candidates are encouraged to prioritise risks identified as this adds to the professionalism of the risk assessment performed.

Group audit
Paper P7 regularly includes questions on group audit issues. Two learning outcomes have been amended in section D2 of the *Study Guide* to clarify the matters that may need to be considered in the planning and execution of a group audit, such as assessment of group and component materiality, the impact of non-coterminous year-ends within a group, and changes in group structure.

Materiality is an important issue in group audit, as the materiality of individual components to the group as a whole, and the materiality of transactions in individual financial statements and in the consolidated financial statements will need careful consideration. Items that are material in individual financial statements may not be material in the consolidated financial statements, and the amount of audit evidence that needs to be obtained to support the group audit opinion is clearly affected by this.

Non-coterminous year-ends can cause problems for the auditor. Under IFRS 10, *Consolidated Financial Statements*, the parent and subsidiaries are required to have the same reporting dates, or consolidation should be based on additional financial information prepared by subsidiary, unless impracticable. Where impracticable, the most recent financial statements of the subsidiary are used, adjusted for the effects of significant transactions or events between the reporting dates of the subsidiary and consolidated financial statements. The difference between the date of the subsidiary's financial statements and that of the consolidated financial statements shall be no more than three months Non-coterminous year-ends cause an issue for the auditor as there may be transactions included in the consolidated financial statements that have not been audited. For example, if the Group year end is 31 December, but a subsidiary has a year end of 31 October, the financial statements of the subsidiary as at 31 October will have been subject to audit, but the transactions in November and December will not have been audited prior to consolidation. This can create a risk of material misstatement, and the group auditor must plan to obtain sufficient appropriate evidence about transactions or adjustments made in respect of the period that has not been subject to audit.

In terms of changes in group structure, many groups are highly acquisitive, and expand operations by frequent additions of new companies to the existing group structure. The consolidation of new components into the group can cause issues for the group auditor. For example, business understanding will have to be obtained for the new component of the group and potentially new component auditors will have to be liaised with. There will be new transactions and balances to understand and audit, such as fair value adjustments made to assets and liabilities acquired, goodwill arising on the business combination, measurement of newly acquired non-controlling interests and new related party transactions to identify.

Equally important are changes in group structure involving the disposal, or partial disposal of a component of the group. Typically this involves the parent company selling all, or part of an investment in a subsidiary. The group auditor will have to plan the audit of the disposal transaction, including consideration of the accounting treatment of the gain or loss arising on the disposal, and of any residual investment remaining after a partial disposal.

Both acquisitions and disposal may change the size as well as the structure of the group, having implications for the assessment of materiality of remaining components and individual transactions.

For UK and Ireland adapted papers only
Two syllabus areas have been amended in the UK and IRL adapted papers only. The more significant changes are in syllabus area E7 Auditing aspects of insolvency, in which several new learning outcomes have been added, including:

- Explain the consequences of liquidation or administration for a company and its stakeholders.
- Advise on the differences between fraudulent and wrongful trading and the consequences for the company directors.
- Examine the financial position of a company and determine whether it is insolvent.
- Identify the circumstances where administration could be adopted as an alternative to liquidation, and explain the benefits of administration compared to liquidation.

These learning outcomes focus on the practical ways in which the auditor can become involved in the auditing aspects of insolvency, particularly when an audit client is facing financial distress. Auditors are often asked to advise management of such a company on actions that could be taken, and directors may be concerned that fraudulent or wrongful trading has occurred and need to understand the difference between the two. It is also crucial that where management has not necessarily asked for the auditor’s input, the auditor can determine whether a company is insolvent and advise management that this is the case.

In addition, in the current issues syllabus area G, a learning outcome has been included in relation to discussing current APB developments. It is important that candidates are aware of newly examinable APB documents as these can form the basis of a current issues requirement.

Professional marks
A change is being made to how professional marks will feature in Paper P7. From June 2012, four professional marks will be available in one of the Section A questions. This change is in common with other Options papers, and is to improve consistency of the exams. The way that marks will be awarded will not change – the professional marks will be awarded for the clarity of explanation or evaluation provided, the use of a logical structure in the answer and an appropriate format including introduction and conclusion.

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