



# Examiner's report

## Audit and Assurance (AA)

### September 2018

#### **General comments**

The Audit and Assurance exam is offered in both computer-based (CBE) and paper-based formats. The structure is the same in both formats but our model of delivery for the CBE exam means that candidates do not always receive the same set of questions. In this report, the examining team share their observations from the marking process to highlight strengths and weaknesses in candidates' performance, and to offer constructive advice for future candidates.

- Section A objective test case questions – here we look at the key challenge areas for this section in the exam.
- Section B constructed response questions - here we provide commentary around some of the main themes that have affected candidates' performance in this section of the exam, identifying common knowledge gaps and offering guidance on where exam technique could be improved, including in the use of the CBE functionality in answering these questions.

There were two sections to the examination and all the questions were compulsory. Section A consisted of three OT cases each comprising five OT questions for a total of 30 marks, which covered a broad range of syllabus topics. In Section B candidates were presented with one constructive response question worth 30 marks and two constructive response questions worth 20 marks each; testing the candidates' understanding and application of audit and assurance in more depth.

In order to pass this examination, candidates should ensure they devote adequate time to obtain the required level of knowledge and application. Candidates who do not spend sufficient time practicing questions are unlikely to be successful as the written questions in particular aim to test candidate's application skills

#### **Section A**

It was very pleasing to see that once again almost all candidates attempted all 15 questions, across the three OT cases. Candidates preparing for future sessions are advised to work through the past exams which are available and to carefully review how each of the correct answers were derived. Section A questions aim to provide a broad coverage of the syllabus, and future candidates should aim to revise all areas of the AA syllabus, rather than attempting to question spot. Section A in the September 2018 examinations included, but was not limited to, questions on the following areas:

- Professional ethics and application of ACCA's Code of Ethics and Conduct
- Corporate Governance
- Substantive testing including testing on tangible and intangible non-current assets and investments
- Subsequent events
- Audit finalisation and review; and
- Auditor's reports

#### **Sample questions for discussion**

The following questions are reviewed with the aim of giving future candidates an indication of the types of questions asked, guidance on dealing with exam questions and to provide a technical debrief on the topics covered by the specific questions selected. Candidates are reminded that there will be a mix of application and knowledge questions in Section A and it is imperative that they ensure their knowledge of the International Standards on Auditing (ISAs), and important areas of the syllabus such as audit procedures is at an appropriate level.

### Example 1

**Which TWO of the following are objectives of the external auditor?**

- A To consider the adequacy of the accounting records which have been maintained
- B To confirm the company will continue trading for the foreseeable future
- C To obtain an understanding of the internal control system in place
- D To access the books and records of the company

The correct answers are A and C.

The auditor does not guarantee the going concern status of the company. Accessing the books and records of the company represents one of the rights of the auditor which enables them to achieve their objectives.

This question is a straightforward knowledge-based question. Candidates should be reminded of the importance of having a good understanding of the basic principles of the role of the auditor. This question was not well-answered in the exam, with many candidates misunderstanding the auditor's responsibility regarding going concern and confusing the auditor's rights and responsibilities.

### Example 2

X Co has a year ended 30 June 20X8. At the end of June 20X8 the company's corporate headquarters building was revalued by a reputable firm of surveyors.

**Assuming a reliable valuation is obtained, which of the following procedures should be performed to obtain sufficient appropriate substantive evidence about the carrying amount of X Co's corporate headquarters?**

- (1) Review the board minutes to ensure that the decision to revalue the headquarters was approved by the board
- (2) Agree the revalued amount in the valuation statement to the amount recorded in the non-current asset register
- (3) Recalculate the revaluation adjustment and agree that it is correctly recorded in the revaluation surplus
- (4) Confirm with the directors that all other assets in the same class as the headquarters have been revalued and agree this to the accounting policy disclosure

- A 2 and 3 only
- B 1, 2 and 3
- C 2, 3 and 4
- D 1 and 4

The correct answer is A.

This question demonstrates two important points. Firstly, candidates should ensure that they **understand** the difference between a test of control and substantive procedures. The test described in (1) is a test of control (ie it provides evidence as to whether the control of board approval has operated effectively) and therefore

does not provide substantive evidence. The question also highlights the importance of reading all information provided carefully. The test described in (4) is a valid procedure but it provides evidence regarding other assets, not the headquarters as specified in the requirement.

## **Section B**

The constructed response questions in Section B tested candidates understanding of the audit and assurance syllabus:

- Audit framework and regulation
- Planning and risk assessment
- Internal control
- Audit evidence
- Review and reporting

### **Audit framework and regulation**

This area of the syllabus requires; an understanding of the functions of an audit, and an understanding of both corporate governance and professional ethics.

Questions in this area may present candidates with a scenario-based ethics or corporate governance question. Candidates are generally asked to identify and explain a set number of issues from a given scenario and give relevant recommendations to address the issues identified. An important point to note when making recommendations for ethics and corporate governance questions is that the recommendation must be an action. Often candidates provide objectives rather than actions. 'Hurling Co' from the 'Sample March/June 2017 Questions' is a good scenario based question to practice the skill of explaining ethical issues and making relevant recommendations.

In addition questions in this area can be stand-alone knowledge based, such as confidentiality or assurance, and do not need to be applied to the scenario provided in the question. In answering knowledge questions it is important to ensure that an adequate level of detail is provided, as often these questions are answered too briefly, almost in a note format. It is also important to identify the requirement verb, as 'describe' or 'state' require completely different levels of detail to be provided.

### **Planning and risk assessment**

This area of the syllabus requires an understanding of how the auditor obtains and accepts audit engagements, obtains an understanding of the entity and its environment, assesses the risk of material misstatement and plans an audit of the financial statements.

Questions on assessing audit risks tend to be scenario based; the candidates having to identify and explain the risks from a scenario and give an auditor's response to address the risks. Other questions in this area of the syllabus tend to be more factual knowledge based questions and hence depend on the ability of students to recall their knowledge in the exam.

As noted in previous Examiner's Reports a fundamental factor in planning and assessing the risks of an audit of an entity is an assessment of audit risk, and this remains a highly examinable area. Audit risk questions typically require a number of audit risks to be identified ( $\frac{1}{2}$  marks each), explained ( $\frac{1}{2}$  marks each) and an

auditor's response to each risk (1 mark each). Typically candidates can be required to identify and explain in the region of six to eight risks and responses.

The scenarios usually contain more issues than are required to be discussed. It is pleasing that candidates planned their time carefully and generally only attempted to list the required number of issues. A point to note is that there may be risk factors at the beginning of the scenario in the opening paragraph, and these are being missed by candidates. Again in this session the opening paragraph of some risk questions stated that the company being audited was a new client. This gives rise to a detection risk. However many candidates still failed to spot this. Additionally, it is important that specific issues from the scenario are considered rather than general audit risks. In this session a question scenario contained a risk relating to the capitalisation of servicing and maintenance costs within PPE. Credit was therefore not given for general capital vs revenue risks, as the answer needed to focus on the incorrect capitalisation of the servicing and maintenance costs and how this should be audited.

As stressed in previous exam sessions, a significant number of candidates did not explain how each issue could impact on the audit risk and therefore were not awarded the second ½ mark. To explain audit risk candidates MUST state the area of the accounts impacted with an assertion (e.g. cut off, valuation etc.), or, a reference to under/over/misstated, or, a reference to inherent, control or detection risk. Misstated was only awarded credit if it was clear that the balance could be either over or understated. A significant minority of candidates stated the risk was 'under/over stated' when it was clearly one or the other. They were not awarded credit and this scattergun approach is not recommended.

An auditor's response does not have to be a detailed audit procedure, rather an approach the audit team will take to address the identified risk. In common with previous sessions, auditor responses were sometimes too weak e.g. "discuss with management". In addition it was noted that there was a significant increase in responses which focussed on what management should do rather than the auditor, and/or, were inappropriate to the scenario. Also some candidates suggested the acceptable accounting treatment such as 'inventory should be valued at the lower of cost and NRV' as an auditor response. This would have gained no marks as it is not an approach for the auditor to adopt in auditing the risks. 'Blackberry Co' from the 'Sample March/June 2018 Questions' is a good scenario based question on audit risks and responses to practice.

Audit risks and response questions can also be linked with a factual knowledge question; 'Cupid & Co' from the 'Sample September/December 2017 Questions' or 'Blackberry Co' from the 'Sample March/June 2018 Questions'

being good questions to practice. In recent sessions candidates have not performed as well as they could have in these factual questions. Future candidates are reminded that they must revise all areas of the syllabus and spend adequate time learning knowledge areas in preparation for the exam.

Audit risk questions can also be combined with a requirement to calculate ratios, these ratios then link into the risk and responses requirement. 'Centipede Co' from the December 2016 exam is a good question to practice the skill of calculating ratios and applying these to a risk and response question. Candidates tend to score well in calculating ratios, however a few points to note are:

- Do not calculate more than the required number of ratios as this wastes time
- Do not provide the formula for ratios, as no credit is available.

As in all other areas of the syllabus, it is important that the candidate carefully reads the specific requirement of the question. For example, in this session where the question asked for a description of the responsibilities of the auditor following ISA 240: 'The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements', no credit was awarded for explaining the responsibilities of management.

### **Internal control**

This area of the syllabus requires both an ability to describe and evaluate internal controls techniques and audit tests. It also requires an ability to make appropriate recommendations as well as being able to distinguish between the scope of internal and external audit.

Internal control questions typically require internal control deficiencies to be identified ( $\frac{1}{2}$  marks each), explained ( $\frac{1}{2}$  marks each), a relevant recommendation to address the control (1 mark), and, often a test of control the external auditor would perform to assess whether each of these controls, if implemented, is operating correctly (1 mark). Internal control questions can also include the identification ( $\frac{1}{2}$  marks each) and explanation ( $\frac{1}{2}$  marks each) of key controls as well as tests of controls (1 mark) to assess if the key controls are operating effectively. Further, these applied internal controls may be required to be presented in the form of a report to management, in which case a covering letter (2 marks) is required.

Internal control questions often include a knowledge requirement. In common with planning and risk questions, these are relatively straightforward marks and candidates should be attempting to score maximum marks. However it was disappointing to see once again in this session that many candidates failed to score many marks in knowledge requirements. It is imperative that future candidates ensure that they devote adequate time to learning the knowledge areas of the syllabus as well as practicing this style of question. A good example question is 'Heraklion Co' from the September 2016 exam and a good question to practice internal audit is 'Raspberry Co' from the 'Sample March/June 2018 Questions'

Internal controls questions remain a highly examinable area and performance in September 2018 was mixed. The scenarios included in exam questions contain more issues than are required to be discussed. In this sitting it was noticeable that for some scenarios, especially those around the cash cycle and the payroll cycle, candidates did not identify (for  $\frac{1}{2}$  marks each) an adequate number of control deficiencies from the scenario. Candidates must be prepared to apply their knowledge of standard control cycles to the given scenarios.

Additionally it was disappointing that some candidates were not able to identify key controls; often identifying the existence of a control where in fact there was a deficiency. As an example, if the scenario states, "holiday forms are required to be authorised, however this does not always occur" the fact that the company uses holiday requests forms is not an effective control in itself and would not be awarded a  $\frac{1}{2}$  mark for identification. In this instance the correct conclusion to draw would be that the lack of authorisation of the forms was a control deficiency.

In common with previous sittings many candidates did not clearly explain the implication of the deficiency. It is important the explanation fully details the impact to the company. As an example, for a deficiency of "daily sales sheets are emailed to head office on a weekly basis" a suitable, well explained implication could be "sales sheets may be misplaced leading to incomplete sales and cash data". Many candidates did not go on to explain the impact on the company, in this example, that sales and cash data may be incomplete.

Most candidates were able to provide good recommendations to address the deficiencies they identified. However some of the recommendations were either poorly described, did not clearly address the specific control deficiency identified or were impractical suggestions. Additionally as with ethics and corporate governance questions, recommendations must be actions rather than just objectives.

'Equestrian Co' from the 'Sample March/June 2017 Questions' is a good internal control deficiencies and recommendations question to practice.

As in previous sessions it was disappointing that candidates' descriptions of tests of controls that an auditor should perform were often not well explained (e.g. repeated use of the word "check"), did not address the controls identified, or, described substantive audit procedures rather than tests of control. In addition in awarding credit for tests of controls weak tests such as 'observe' do not score as well as inspection or enquiry type procedures. For some controls it is perfectly acceptable for observation to be used as an audit procedure, such as attendance at an inventory count. However, for testing authorisation controls, the focus should be on inspecting for evidence of authorisation of previous documents rather than observing an individual authorising a document during the audit.

Tests of controls are a key requirement in internal control questions and future candidates must ensure they practice these types of questions in advance of their exam. 'Raspberry Co' from the 'Sample March/June 2018 Questions' is a good question to practice, testing internal control deficiencies and recommendations and key controls and tests of controls.

### **Audit Evidence**

This area of the syllabus requires a description of the work and evidence obtained by the auditor required to meet the objectives of audit engagements and the application of International Standards on Auditing.

A key requirement of this part of the syllabus is an ability to describe relevant audit procedures for a particular class of transactions or event. Overall performance in this key syllabus area in this exam session was once again very disappointing.

The September 2018 exam session contained a number of questions in this syllabus area covering a variety of areas across both the statement of profit or loss and statement of financial position, illustrating that candidates must be prepared to tailor their knowledge of substantive testing to any area of the financial statements. In most cases candidates remain unable to tailor their knowledge of general substantive procedures to the specific issues in the question requirements, with many providing tests of controls rather than substantive procedures, providing incorrect procedures, or concentrating on one type of test, for example, multiple examples of analytical review procedures. In addition care must be taken regarding the type of company described in the scenario, companies providing services will not have goods despatch notes (GDNs) and therefore tests focusing on GDNs would have scored no marks.

In particular care must be taken to address the specifics of the question; often the requirement is to describe substantive procedures to address specific financial statement assertions, such as valuation. Any tests provided which did not test this assertion would not have scored any marks. A good example to practice is 'Dashing & Co' from the 'Sample September/December 2017 Questions'.

In addition candidates should read the AA Technical Article 'The Audit of Financial Statement Assertions'.

As addressed in previous Examiner's Reports candidates must strive to understand substantive procedures. Learning a generic list of tests will not translate to exam success – procedures must be tailored to the specific requirements of the question. Additionally tests must be sufficiently detailed noting clearly which source document should be used. A significant number of candidates suggest tests such as 'review disclosures' however this would only have scored ½ marks as they did not go on to say 'in accordance with accounting standards'. Also recommending 'obtain a management representation' without explaining what for, e.g. to ensure completeness/reasonableness of, for example, a provision will not generate any marks.

A good example of a substantive procedures question to practice is 'Gooseberry Co' from the 'Sample March/June 2018 Questions'.

There are many resources available on the ACCA's website which will help you prepare and reviewing these, along with past exam questions, is one of the best ways to help you cover the syllabus and get used to the style of the questions.

### **Review and reporting**

This area of the syllabus requires an understanding of how consideration of subsequent events and going concern can inform the conclusions from audit work and their impact on the auditor's report, written representations and the final review and auditor's report.

Questions in this area of the syllabus tend to be scenario based and may require candidates to describe audit procedures in relation to going concern or subsequent events and one mark is available for each well-described procedure. Alternatively they can require an assessment of the impact on the auditor's report due to an unresolved accounting issue.

Overall the performance in auditor's report questions this session was disappointing in comparison to previous sessions. Candidates are often required to discuss an accounting issue, assess whether the error is material, consider the type of modification, if any, and lastly to discuss the impact on the auditor's report. Answers must clearly state the opinion to be issued (ie unmodified opinion or modified opinion), and if the opinion is to be modified, the type of modified opinion which is appropriate (ie qualified opinion, adverse opinion, disclaimer of opinion). Candidates are advised to ensure that they are as knowledgeable on modifications caused by insufficient evidence as they are for material misstatements.

Once again this session many candidates seemed to omit the discussion of the issue which would score 1 mark. In order to be awarded marks for discussing the issue candidates should not just re-write the issue from the question. Candidates need to explain the effect of the item being incorrectly recorded, for example, if this results in assets/liabilities/profit being over/understated. In calculating materiality for auditor's report questions it is not necessary to show the workings of how materiality was calculated as there is only ½ marks available for this.

In this session candidates were required to consider the impact on the auditor's report of adequate and inadequate disclosure. Answers should have addressed each of these as two separate requirements, considering whether any additional information would be required in the auditor's report for 'adequate

disclosure' and if the opinion would be impacted. Candidates tended to perform better on 'inadequate disclosure', as this resulted in a modification of the opinion.

Unless stated otherwise in the question requirement, candidates should only include the type of modification required if the company does not adjust for the issue in the financial statements. Weaker candidates continue to discuss what the report will look like if the error is adjusted for and if it is not. This is not an efficient use of time as only responses which answer the question will generate marks.

Auditor's reports are a core area of the syllabus and knowledge of the ISAs in this area is imperative. Good questions to practice are 'Airsoft Co' from the 'Sample March/June 2017 Questions' and 'Gooseberry Co' from the 'Sample March/June 2018 Questions'. In addition candidates should read the AA Technical Article 'The Auditor's Report'.

### **Exam technique**

Good exam technique is vital for success in AA. It was pleasing to see many candidates followed the instructions in audit risk and internal control questions and structured their answer in columns. Not only does this make it easier to mark, it makes it easier for a candidate to review their answer and ensure they have covered all of the relevant areas, for example it is clearer to see if a test of control has been omitted. A minority of candidates are writing out the questions in their answer booklet, this is not necessary as it is not marked and it wastes time.

Additionally, it was pleasing that where a question asked for a specific number of issues to be addressed, such as risk and internal control questions, most candidates attempted to identify the required number demonstrating appropriate exam technique and time management.

Once again it was disappointing to see that some question requirements were not attempted. This tended to be in knowledge areas and substantive testing questions. This could have been down to a lack of knowledge or exam preparation.

Candidates need to ensure that their answers relate to the scenario given. In questions requiring a description of substantive procedures these were often too generic. Candidates need to particularly ensure that substantive procedures and tests of control are clearly described as to exactly 'how' the procedure should be performed. Also an adequate number of procedures must be provided; a four mark question should have at least four well described procedures to maximise the candidates mark.

### **Word processing technique**

Candidates sitting CBE questions used the word processing tools available adequately. It was pleasing to see that the length and depth of many CBE answers was significantly expanded on previous sessions. However please note that when answering into a pre-formatted table, providing bullet points is acceptable, however answers must be sufficiently detailed and not note like in order to maximise marks.

Very occasionally, the typed words in some candidates' answers were difficult to understand as the words were misspelt. Candidates are reminded that there is no automatic spelling checker tool available and to try and manage their time appropriately to allow for a review of their answers before submission. Also when reviewing answers look out for omission of key words, for example the omission of the word NOT can completely change an answer.



There are resources on ACCA's website giving more guidance on how to use the word processing tools. A video introducing the main functionality and how to make best use of these in AA can be accessed via the video an introduction to Audit and Assurance CBEs.

### **Guidance and Learning Support resources to help you succeed in your exam**

Preparing for the AA exam can appear challenging but there are many resources available to help you. You should refer to these throughout your studies.

You should make sure you have made use of all of the resources found [under technical articles for AA](#) – these include technical articles, study support videos and exam technique resources – all developed with you in mind.

Additionally [Examiner's Reports](#) are available after each exam session. These are a valuable tool for understanding the exam, avoiding common pitfalls and developing exam technique. Work through the AA resource 'A guide to using the examiner's report' if you are sitting the exam for the first time or 'A guide to reflection' if you are retaking your exam. Both of these interactive tools can be found under the [technical articles page](#) for AA. These have been developed to sit alongside the self-study guide and the [retake guide](#) respectively, and provide you with further pointers for using the examiner's reports for previous sittings.

It is essential to practise as many exam standard questions as you can in the lead up to your exam, this is critical for AA as 70% of the marks are written. We strongly recommend that you use an up to date question and answer bank from one of our [Approved Content Providers](#) but if this is not possible then work through the most [recent past exams](#) on our website. However, please note if you are using the past exams that these are not updated for syllabus changes or changes to the exam format since September 2016 and so should be used with caution – so check the [latest syllabus and study guide for changes](#).

It is essential that you have a good understanding of the verbs typically used in ACCA AA exam questions. Take a look at the article [What is the examiner asking?](#) which sets out some of the most commonly used verbs, and ensure that you understand how these are used in the AA questions.