



Examiner's report

F8 Audit and Assurance

December 2016

General Comments

There were two sections to the examination and all the questions were compulsory. Section A consisted of three OT cases each comprising of five OTs for a total of 30 marks, which covered a broad range of syllabus topics. Section B had one constructed response question worth 30 marks and two constructed 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 constructed response questions in particular aim to test candidate's application skills.

Specific Comments

Section A

It was very pleasing to see that almost all candidates attempted all 15 questions, across the three OT cases. Candidates preparing for the next examination of F8 are advised to work through the specimen exam and all available past exam questions 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 F8 syllabus, rather than attempting to question spot.

The first case on Corporate Governance focussed on the responsibilities and roles of the audit committee, remuneration committee and internal audit. Candidates performed well on four of these questions however performance was unsatisfactory on a question that required an understanding of the role of internal audit. Performance was satisfactory on the second case which focussed on audit review, finalisation and reporting. Performance on the third case was mixed. The third case focussed on substantive testing and reliability of audit evidence. Candidates performed well on the reliability of audit evidence and application of the cut off assertion. However, candidates' performance was disappointing on two of the substantive tests questions

Section B

The three 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

Question sixteen

Question 16 for 30 marks covered the areas of matters to consider before accepting an engagement, calculation of ratios to assist in planning, audit risks and responses, and, safeguards to manage conflicts of interest. Candidates generally performed well in this question.

Question 16a required candidates to discuss matters to consider before accepting an audit. Candidates who scored well discussed the competence /resources available of the audit firm, the contact with previous auditors, ethical considerations and the preconditions of an audit. Some candidates focused on one area in too much detail, for example, only describing the various ethical considerations that could arise. Some candidates incorrectly focussed on the removal of the prior year auditor. Few candidates discussed money laundering, or, risk considerations

Question 16b tested candidates' ability to calculate ratios which would assist in the planning of an audit. This question was generally well answered. Some candidates however only wrote the ratio formula and did not actually calculate the ratio; candidates are reminded to bring a calculator to the F8 exam. Some candidates calculated movements from one year to the next, but this was not asked for in the question. The current and quick ratios were also sometimes either confused between the two or miscalculated. Some candidates incorrectly calculated inventory days using 'revenue' rather than 'cost of sales'.

Question 16c required candidates to identify and explain the risks from a scenario and give an auditor's response to address the risks. 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). Performance in the audit risk question in December 2016 was mixed.

The scenario contained a significant number of issues, and most candidates were able to identify the required number of issues. A significant number of candidates did not explain how each issue could impact on the audit risk and therefore were not awarded the second $\frac{1}{2}$ mark. To explain audit risk candidates need to 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 if it was clear that the balance could be either over or understated. For example, when explaining the risk of inventory days increasing ($\frac{1}{2}$ marks for the issue), credit was only awarded for the audit risk of inventory being overstated ($\frac{1}{2}$ marks for the explanation).

Auditor's responses were mixed. While 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, the responses given were sometimes either too weak e.g. 'discuss with management' or, did not address the issue due to a failure to understand the risk.

In comparison to recent exam sessions, it was pleasing that fewer candidates discussed business risks in December 2016. However, a minority of candidates continued to concentrate their responses on what management should do rather than the auditor. For example, in relation to inventory, an inappropriate response was to 'put in a FIFO system for inventory'.

Question 16d covered safeguards an audit firm should implement to ensure that a conflict of interest is properly managed. Candidates who scored well discussed a range of safeguards such as the audit team configuration, procedures to prevent access to information, notifying the client to obtain consent, and, obtaining confidentiality agreements. However some candidates concentrated too much on just one area. For example listing as different points; separate teams, restriction on reassignment of audit team members, and, different engagement partners – when all three are examples of team configuration. Some candidates focused on ethical issues, such as ensuring the auditor has no shares in the client, which was not relevant for this question. Candidates need to be clear

when describing the safeguards, for example candidates often mentioned that confidentiality agreements were required but often were unclear who the agreement should be with, occasionally incorrectly noting that the agreement should be with the client.

Question seventeen

Question 17 for 20 marks covered the area of control objectives, internal control strengths and internal control deficiencies. Performance across this question was mixed.

Question 17a required candidates to state control objectives of a cash receipts system. Candidates' performance was disappointing. A significant number of candidates identified control procedures rather than control objectives. In addition, many candidates did not link objectives specifically to the cash receipts system.

Question 17b required candidates to identify ($\frac{1}{2}$ marks each), explain ($\frac{1}{2}$ marks each) of the internal control strengths from the scenario and describe a test of control, for each strength, that the auditor could perform (1 mark each). Performance was mixed in this question. Candidates often correctly identified strengths from the scenario but few explained why it was a strength ie few described the implication for the company. For example, candidates identified the strength of 'monthly bank reconciliations' ($\frac{1}{2}$ marks) but few candidates noted the implication ($\frac{1}{2}$ marks) 'a key control over cash and bank which ensures completeness of cash receipts and transactions'.

The scenario in the exam contained more strengths than were required to be discussed and it was therefore pleasing that candidates generally only identified the required number of strengths noted in the question.

The tests of controls were of a mixed standard. Some of the tests were poorly described and many described substantive rather than control tests. Candidates are advised that to test a control they need to ensure the client has carried out the control.

Question 17c required candidates to identify ($\frac{1}{2}$ marks each), explain ($\frac{1}{2}$ marks each) the internal control deficiencies from the scenario and describe a test of control for each deficiency that the auditor could perform (1 mark each). Internal control question remain a highly examinable area. It was pleasing to note that candidates generally performed well in this question.

Candidates were able to identify the internal control deficiencies from the scenario, however many candidates did not clearly explain the implication of the deficiency. In order to gain the $\frac{1}{2}$ explanation mark for the deficiency, candidates must fully explain the impact on the business. Often the explanation of the deficiency was too vague. For example, the implication of there being no individual logons being described as 'could lead to fraud' was not awarded any credit. Candidates needed to explain the implication for the business that 'they would not be able to determine who was in charge of the till if a discrepancy arose'.

The scenario contained a significant number of issues, and it was pleasing to note that most candidates were able to identify the required number of issues

Most candidates were able to provide good recommendations to address the deficiencies. However some of the recommendations were either poorly described, did not clearly address the specific control weakness identified, were impractical suggestions or were incomplete. For example for the deficiency 'all employees can access all tills', a common recommendation was 'to have each employee accessing their own till' which would be

impractical with only three or four cash tills per store on average. Candidates are reminded that they should tailor their recommendation to the circumstances presented in the scenario.

Question eighteen

Question 18 for 20 marks covered substantive procedures and the auditor's report. Performance across this question was disappointing.

Question 18a required candidates to describe substantive procedures to assess the completeness of income. In this type of question one mark was awarded for each well described procedure. As in previous diets, performance in questions requiring substantive tests to be described continues to be disappointing. Most candidates did not understand the implications of testing for completeness and / or the implication of being a not-for-profit organisation. Many candidates therefore just gave standard tests over income such as agreeing goods despatch notes to invoices. Many candidates also placed too much emphasis to the cash at bank suggesting a bank reconciliation should be performed, with no reference to donations or income.

Most candidates were unable to tailor their knowledge of general substantive procedures to the specific issues in the question requirements, or provided vague tests such as 'check' or objectives of 'ensure that....' 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.

Question 18bi required candidates to describe substantive procedures for trade payables as the purchase ledger was kept open one week longer than normal. One mark was awarded for each well described procedure. Performance in this question was also disappointing. Candidates often listed general trade payable tests and did not relate to the specific requirement of the question. Although many candidates suggested suitable analytical review tests such as compare with prior year figure, few provided a full procedure by ensuring that 'significant differences should be investigated' and hence only scored ½ marks. Many candidates did attempt to explain a cut off test however often, incorrectly, described sourcing the sample from invoices rather than goods received notes. Many candidates suggested testing purchase orders to goods received notes and invoices, however this would not verify the year-end trade payable balance.

Question 18bii required candidates to describe substantive procedures for trade receivables as the trade receivable days had increased. Again one mark was awarded for each well described procedure. Performance in this question was disappointing. Candidates again generally listed general trade receivable tests and did not relate to the specific requirement of the question. Many candidates incorrectly included substantive tests such as analytical review, receivable circularisation, cut off testing, reconciling the ledger to the control account etc., which are not relevant to the question. Candidates must read the question carefully and apply their knowledge to the scenario provided.

Question 18c required candidates to describe the impact on the auditor's report if the issues remained unresolved. Performance was mixed across this question, however overall performance on auditor's reports showed an improvement over previous diets. Most candidates correctly calculated materiality and correctly suggested the type of modification. However many candidates repeated the facts from the scenario and/or discussed how to resolve the issue. Few candidates noted that the issue resulted in trade payables being understated and therefore the bank overdraft being overstated. While most candidates correctly stated the impact



on the auditor's report would be an 'except for' opinion, few discussed the need to include a 'basis of qualified opinion' paragraph.