Examiner's report

P7 Advanced Audit and Assurance
December 2016

General Comments

The examination consisted of two sections. Section A contained one question for 35 marks and one of 25 marks which were both compulsory. Section B contained three questions of 20 marks each, from which candidates had to answer two questions.

As in previous examination sessions, to score well in the exam candidates needed to demonstrate good technique combined with a strong appreciation of the syllabus, building upon knowledge from both F8 Audit and Assurance and P2 Corporate reporting. Candidates and tutors will also need to be aware of current developments in the field and should take note of the inclusion of new examinable documents and updates to the syllabus in conjunction with recent articles published by ACCA relevant to the syllabus.

In this exam, well prepared candidates demonstrated an ability to use their knowledge and experience to relate their answers to the question requirements given. Generally, candidates were able to demonstrate good time management and address the required number of questions. However, many candidates appeared to have lost focus on the requirement or failed to appreciate it in detail and therefore gave answers which were irrelevant and could not gain credit.

For candidates preparing for this exam, it is especially important to focus on tailoring the number of points written to the mark available and to take note of areas that the requirement flags as not required. It is also important to consider at which stage of the audit process a scenario is occurring. At the planning phase of an audit the report outcome is unlikely to be a discussion point, at completion there may be a requirement for additional procedures to occur but this is not generally something that occurs at the reporting stage when candidates are told the testing is complete and concluded on correctly.

Specific Comment

Question One

This question was set at the planning stage of the audit and related to a large airline with several divisions aimed at different sectors of the market. The client was new but had already been accepted therefore acceptance procedures were not relevant. Part a required candidates to explain business risks facing the company from the information provided and additionally credit was also available for the inclusion of risks specific to the industry. Part b asked for risks of material misstatement (RoMM). The wording of the requirement was similar to that of Question one from the December 2014 exam.

In part a, which was worth 10 marks, the majority of candidates were able to describe risks from a business perspective although a significant number discussed audit risk and hence did not address the requirement. It should be noted that although the relative size of expenditure or business segment is relevant to prioritising risks, materiality is an audit concept and the conclusion as to whether an item is material should be discussed in an audit risk or RoMM context where required. Strong answers here were able to take the information given and describe a variety of risks arising from those. Weaker answers copied text from the scenario without adding the implication for the company or listed generic and possibly rote learnt risks such as "the company is listed and might breach listing rules" despite being told the client was fully compliant with Corporate Governance regulations and there being no hint that it would not be compliant, or that valuation of inventory was a significant risk despite inventory being a minor part of the business with nothing in the requirement suggesting an overvaluation risk.

In part b candidates were required to provide four risks of material misstatement in the financial statements. The question clearly stated that disclosure requirements should not be included and would be assessed at a later stage in the planning process. Given this, it was disappointing how many candidates had not taken note of that fact and spent a large amount of exam time discussing operating segment disclosure requirements or the consolidation process. Weaker candidates again resorted to commenting on what may have been rote learnt risks such as brand recognition and inventory valuation which were not relevant to the requirement. It was telling that some of those candidates started their discussion of those points with comments such as “we are not told if the company has any brands on its balance sheet but if it does they should not be capitalising internally generated brands” or “despite inventory being immaterial”. It is unlikely that an immaterial item or an item not on the balance sheet, and which should not be on the balance sheet, will give rise to a material misstatement.

Candidates were also required to recommend additional information required to help the audit team understand internal controls at the client. Strong answers suggested relevant pieces of information likely to exist at the client, for example, the organisation structure or a procedures manual. Many candidates however did not appear to appreciate that the information requested was specific to understanding the company’s controls and either produced a list of pre-acceptance information to aid the decision to accept the audit, information on all the audit risks identified or gave procedures for investigating what we were told was a immaterial fraud identified by the client’s internal audit team.

Finally candidates were required to discuss the ethical implications of the audit committee’s request that the firm assist in the quantification of the inventory fraud for their insurance claim. Here candidates often failed to take their answers beyond the learnt rules for independence threats and did not adapt their answers to the standard required to score well at this level. Candidates could have enhanced their responses by assessing the materiality of the fraud and the fact that for such a small amount the fee was not likely to be material either, hence long discussions about % income caps from clients was not necessary.

Question Two

This question was set in the completion stage of the audit and as is generally the case with completion questions, it was focused on the accounting treatment and audit evidence obtained on three issues. In this case, candidates were also required to discuss the impact of the issues found on the report to those charged with governance. Candidates generally demonstrated a good knowledge of the financial reporting implications of the areas and were often able to identify that the evidence obtained was insufficient and suggest further procedures. For many candidates the control weaknesses in the company and the implication of a deficiency in controls on further audit strategy and testing was not always identified. Candidates’ responses to the matters to include in the report were variable with some candidates discussing auditor’s report qualifications (despite no errors being flagged) or giving general answers to the contents of the report with no reference to the scenario in the exam.

Question Three

Question three was a 20 mark question with two requirements and covered prospective financial information in the form of a cash flow forecast and a related party transaction. Part a required candidates to appraise the forecast and suggest further procedures in assessing the use of the report as part of the going concern review during the audit. This was generally well answered by the majority of candidates attempting the question.

In part b candidates were required to discuss a loan from the chief executive to the company. This had been provided during the year being audited and the audit was still ongoing. Stronger candidates appropriately recognised this as a related party transaction and commented on the materiality and disclosure requirements before going on to describe procedures to perform. There were a significant number of candidates who had failed to take in to account the date the loan was provided and assumed it was missed in the prior year audit so instead focused their answers on a perceived lack of integrity of the directors, inappropriate levels of disclosure in prior year financial statements and audit qualifications.

Question Four

This question examined the concept of scepticism in the context of a group audit where the parent company was reluctant to provide more than verbal assurances that they would support the loss making subsidiary. The parent company was facing a law suit that they may lose and hence good candidates could explain and apply to concept of professional scepticism by questioning why the parent company would not put the support in writing and whether this might reflect uncertainty of the parent company's going concern status given the law suit.

Part b required the implications for the audit of the subsidiary in terms of evidence, reporting and pressure from the parent company auditor to refrain from modifying the audit opinion despite insufficient evidence being available.

The structure of the requirements led candidates to conclude the parent company might not be able to provide support, that a lack of evidence had been obtained in this regard, there was an ethical threat of intimidation and then discuss the auditor's report and the modification required. Disappointingly candidates often stated correctly that there was inability to collect sufficient appropriate evidence but the incorrectly proposed an adverse opinion.

Question Five

The final question examined current issues in audit reporting. Candidates were asked for a discussion of the newly introduced Key Audit Matters (KAM) section of auditor's reports for listed companies. Candidates that attempted this question had a good knowledge of the new disclosures and potential difficulties auditors might face. It was common for candidates to score high on this requirement.

Part b of the requirement provided information on three issues that had been dealt with during the audit and requested candidates discuss the impact of the matters on the auditor's report. This question was set once completion processes were almost complete and looked specifically at the implications for the auditor's report. This included the application of the points candidates had discussed in part a, ie KAMs. In two of the issues, candidates were clearly told in the question that the audit team had concluded the issues were correctly presented and disclosed within the financial statements and hence should have identified that the items were KAMs requiring disclosure. Credit was available for justifying the inclusion as a KAM and for what would be included in the disclosure. Many candidates however did not consider the KAM and spent time describing further audit procedures or a qualification that would have been required had the audit concluded the items were not appropriately treated in the financial statements. This was disappointing given the lead in to KAM provided in the first requirement.

Conclusion

As stated in the conclusion to previous examiner's report, almost all candidates are able to identify at least some relevant issues to a particular requirement from the scenario, but not all can adequately explain, discuss or describe their points in sufficient depth or detail. Candidates must ensure that they answer the specific requirement which has been set, and focus their answer points on the scenario. Candidates are also reminded that while it is important to have good knowledge of financial reporting, they must be able to link this to the appropriate audit issues that arise in the question scenarios. Candidates are encouraged, as always, to practise past exam questions and to carefully review the model answers and the examiner's reports that accompany the past exam questions.