



# Examiner's report

## P7 Advanced Audit and Assurance

### June 2018

#### **General Comments**

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

The overall marks for this subject continue to be low and candidates need to ensure that they devote sufficient time to studying for this examination and that their knowledge is up to date. In particular candidates need to ensure that their assumed knowledge is sufficient and that they have a good understanding and knowledge of F8 Audit and Assurance and P2 Corporate Reporting. It was not always evident that candidates had adequate knowledge of Corporate Reporting and it is recommended that candidates study for this exam shortly after they take the P2 Corporate Reporting examination.

This examination did seem to have been more time pressured than some other sittings. It was noted that candidates seemed to spend more time answering question one and then appeared to spend less time answering question two and the optional questions. Candidates are reminded of the need to allocate their time appropriately. It is an obvious point to make that not attempting four questions makes it more likely that the candidate will fail. Candidates should spend time reading the exam carefully to identify the questions they will attempt and then need to work through these progressively and to be prepared to leave a question unfinished rather than to use too much of the available time answering it.

It is further recommended that candidates make use of the bank of composite past papers that are available on the ACCA website in order to attempt a mock exam and as preparation for the actual examination. By doing this it will help Candidates manage their time effectively which is a valuable skill in an examination such as this.

Overall candidates appeared to have interpreted the majority of the requirements well although the usual instances of misunderstanding were seen. A number of the scripts contained some good answers but were let down by poor time keeping and as previously described.

#### **Specific Comments**

##### **Question One**

This question required that candidates identify the business risks facing a construction company with several divisions and to explain the significant risks of material misstatement to be considered when planning the audit. In addition candidates were required to recommend the audit procedures to be performed in respect of a restructuring provision and to comment on the ethical issues arising from the suggestion that the audit firm should assist in developing a business plan.

Candidates were able to answer the first requirement quite well and to identify and explain the business risks described within the scenario. Candidates do need to ensure that the risks described are specific to the scenario rather than a listing of generic risks, financial, political etc.

Candidates were less confident when answering the second requirement. There were a large number of risks of material misstatement that could have been identified. A major risk was that management might manipulate the financial statements as an acquisition is planned and they need to raise finance. More specific risks focussed on areas of the statement of financial position and candidates do need to ensure that they have sufficient knowledge of the financial reporting syllabus in order to maximise their marks in this area.

The third requirement was well answered. Again candidates do need to have an understanding of basic accounting principles. The re-training costs of staff to be made redundant as part of the restructuring could not be included in the provision but a disappointing number of candidates did not realise this and suggested procedures often including obtaining details and/or quotes of the training to be provided. Most candidates were able to suggest that evidence was needed to confirm the restructuring was to take place and to then view payroll records to verify the redundancy payments.

The final requirement to discuss ethical issues raised by the request to assist with the business plan also produced some good answers. It was clear that some candidates had studied the relevant article about answering ethical questions on the ACCA website and were able to earn high marks. Candidates need to be able to identify the relevant ethical threat and explain why the threat will affect the auditor's objectivity to earn full marks. Candidates were able to identify that the threats of self-review, management and advocacy were present within the scenario and to suggest possible safeguards. In addition the fee that was being offered was contingent on the client obtaining finance, which is specifically forbidden.

## **Question Two**

This question required students to comment on the quality control, ethical and professional issues raised following the review of an audit at the completion stage.

The first issue centred on the fact that the finance director had posted two late journals. One journal had been accepted by the audit team as being acceptable as it was the same as in the previous year and the other journal was a partial adjustment in respect of an error identified by the audit team. Candidates needed to appreciate that there should have been a control in place to ensure that the journals were approved by someone other than the finance director and then consider the specifics of the journals and the effect of these on the financial statements. Good candidates were able to recognise that both transactions were material and the audit team had been too inclined to accept the clients' explanations and had done insufficient testing. Such candidates were then able to produce a logical listing of further actions and procedures that needed to be taken to support or amend the journals.

The second requirement was centred on an existing job costing system and a newly introduced credit control system. The audit team had failed to record or test the costing system, as they understood there had been no changes. The credit control system was documented based on discussion with the client and the audit procedures on trade receivables were the same as in the previous period. Again stronger candidates were able to discuss the importance of understanding systems and also the need to document these as audit evidence. They then went on to discuss the need to test that the controls within the system were working appropriately so that reliance can be

placed on these in order to adopt a controls approach rather than a time consuming substantive approach to the audit. Again better-prepared students were able to clearly set out the steps, which needed to be taken before the audit could be finalised. Weaker students often were confused by the two different systems and produced repetitive answers.

The final requirement dealt with a member of the audit team who had provided additional review and accounting advice to the client without the knowledge of the audit manager and who received a direct payment from the client. Candidates had a good opportunity to identify and discuss the relevant ethical threats arising in such a situation. However a number of candidates failed to understand that the audit was at the completion stage and those actions such as remove the auditor from the team or to use separate teams would no longer be possible or appropriate.

### **Question Three**

This question focussed on an accident at a nuclear power station that had caused the one of the two reactors to be shut down and also a spill of radioactive material into the sea. This accident had happened only a few days prior to the year end of the client and the candidates were firstly asked to discuss the implication of the event on the completion of the audit together with recommending further actions to be taken.

The main implications were that the financial statements would need to be adjusted to include a provision for reparation and an impairment of the reactor. There was also a need to assess the going concern status of the client and if adequate disclosure had been made of this.

Stronger candidates were able to explain the necessary accounting treatments and adjustments required and to identify the further actions to be taken. Such actions would include assessing the amount of the provision required which was based on the report of an internal expert and good candidates were able to earn extra credit for querying the experts independence and if an auditor's expert should be appointed.

Further actions included requesting management to perform an impairment review and to discuss the going concern of the company and any contingency plans in place.

As a separate exercise the auditors had also been requested to undertake an assurance engagement on the corporate and social responsibility section of the client's integrated report. The candidates were required to explain the difficulties in providing assurance on CSR reporting and to recommend relevant procedures to gain assurance on the client's stated training objective. This was a relatively straightforward requirement for those candidates that had revised this topic. It was also possible to get marks for suggesting basic procedures such as obtaining and verifying the clients own source documents although students were required to specifically name what these would be.

### **Question Four**

This question was centred on the review of a Group of companies and required candidates to consider the matters outlined and to explain what audit evidence would be required.

The first scenario described the accounting treatment of a new acquisition in which the client company had acquired 40% of the voting shares but with an option to acquire the remaining 60% at a discount to the market value. IFRS 10 Consolidated Financial Statements contains specific guidance on such situations when the investor may have control even when a majority of the shares are not held. In this case as the options were exercisable in the near future the acquisition should have been treated as a subsidiary rather than an associate. This question tended to produce poor answers as the majority of candidates proved to be unfamiliar with the relevant accounting standard and hence did not realise the accounting for the acquisition was incorrect.

The second scenario included a foreign subsidiary that used local GAAP rather than IFRS. The subsidiary had forward commodity options with a fair value of \$6.1m that had been disclosed at the year end rather than included on the statement of financial position. Stronger candidates were able to recognise that on consolidation the subsidiary accounts should be aligned with IFRS and the derivatives recognised on the consolidated statement of financial position at fair value with the associated gains or losses being recognised in the consolidated statement of profit or loss. Further credit was then available for considering the evidence required to support the value of the derivatives. A number of weaker candidates disappointingly discussed the need to translate the year-end financial statements of the subsidiary although the question had specifically stated that the subsidiary had the same functional and presentational currency as the parent.

The final scenario concerned the sale between a subsidiary and parent company that took place near to the year end with the sale recognised by the subsidiary before the year end but the goods not received by the parent until after the year end. This was a straightforward situation and the parent should have recorded the goods in transit in its individual financial statements. The fact that this had not been done indicated that there was a control weakness in the recognition and treatment of intra-group balances. Candidates were able to earn marks for discussing the need to eliminate intra group balances on consolidation and for obtaining evidence such as sales invoices, goods despatched notes at the subsidiary and purchase invoices, goods received notes at the parent to confirm dates and amounts. Better candidates were able to discuss the need to confirm the profit element of the transaction and ensure that this was also adjusted for by including a provision for unrealised profit.

### **Question Five**

This was a reporting question and was in two sections. It was noted that this question was favoured by candidates who had obviously read the recently updated relevant article on the student website.

The first requirement was to discuss the benefits and difficulties of communicating key audit matters to users of the auditor's report and how this addresses the audit expectation gap. The answers produced were often good and typically included a brief explanation of what a key matter was together with a list of benefits such as providing greater transparency and understanding of the audit process. Candidates were less likely to include difficulties, which would include a lack of comparability and consistency due to judgement, the possible increase in the volume of the report and the likelihood of standardised disclosures being included.

The second requirement was to critically appraise an extract from an auditor's report, which had been incorrectly prepared and needed amendment. As noted above it was clear that the candidates who selected this question had evidently read the relevant article and were able to identify that the sections were in the wrong order, contained inappropriate wording and that the key audit matters and emphasis of matters paragraphs had been incorrectly used. Good candidates were able to explain when an issue should be included as a key audit matter or if the issue would result in a qualification and hence needed to be part of the basis of opinion paragraph. Other candidates correctly commented that it would be inappropriate to include an emphasis of matter paragraph but that the report should include a section headed material uncertainty related to going concern.

### **Conclusion**

There was an overall improvement in performance this session and it was clear that some candidates had paid attention to the student articles made available on the ACCA website. However, a number of students continue to produce disappointing answers and have not prepared sufficiently to sit an exam at this level. As always students are advised to ensure they devote sufficient time to their studies and to ensure that they have a good understanding of the basics of auditing.