

Examiner's report

FAU Foundations in Audit
December 2012



General Comments

This exam paper continued to have two sections. Section A (worth 20 marks) contained ten multi - choice questions, each worth 2 marks, on topical areas from across the examination syllabus. Section B (worth 80 marks) contained nine compulsory questions, two of which were worth 15 marks, two were worth 10 marks each and the other five were worth 6 marks each.

A reasonably good proportion of candidates answered Section A to a satisfactory standard and a number answered at least seven of the ten questions correctly. However, a significant minority of candidates appeared to have great difficulty with these questions and secured relatively few of the 20 marks available. There was a positive correlation between most candidates' marks in Section A and Section B of the paper. Consequently, whilst some candidates answered to a satisfactory standard in both Sections, for others the paper served only to emphasise (at best) an inadequate understanding of the theoretical and practical aspects of auditing across the various areas of the syllabus examined.

Most candidates scored unsatisfactorily on the 80 marks available in Section B than of the 20 marks available in Section A. Notwithstanding this there were some exceptionally high marks achieved in Section B by a significant number of seemingly very well prepared candidates. Contrary to this, in a higher number of instances the marks achieved in Section B were very low. For many unsuccessful candidates; when answering Section B questions, a relatively common trait was to provide answers which, in substance, relied on phrases used in the question. As an example; at question three - in the context of sample selection, many answers simply "explained" that when making a haphazard selection, the auditor's selection "was made on a haphazard basis". Similarly, in question four where there was a requirement to explain the term "an unmodified audit opinion", a relatively high number of candidates answered along the lines of it being an audit opinion that "is not modified". It was clear that a significant proportion of candidates were not at all properly prepared to sit the exam.

The following deficiencies were again noted as being common amongst this cohort of Candidates:

- i) Not answering all of the questions. Simply put, if a candidate omits to answer just one of the 6 mark questions then they have given up the chance of obtaining 12% of the required pass mark for the paper (50 %). The principle of answering all the required questions is particularly important for all candidates if they wish to increase their chances of passing this paper. Good learning preparation, combined with good time management when sitting the exam are key to achieving this.
- ii) Not following the requirements of questions – for example not 'explaining' matters or issues when requested to do so, or by describing irrelevant or incorrect matters or issues.
- iii) Writing answers that are either far too brief and therefore lacking insufficient detail to justify any more than a small fraction of the available marks or, alternatively, writing very long rambling answers containing totally incorrect or irrelevant material - and obtaining none of the marks available.
- iv) Incorrectly asserting that it is the auditor's responsibility to ensure that the financial statements show a "true and fair view" or to issue a "true and fair report" (or similar).
- v) Presenting illegible answers (perhaps by rushing).

In summary, whilst a fair number of candidates performed satisfactorily in this exam, there were some who should now take the opportunity to review their whole approach to studying for this paper, and there are others who need to work hard to improve their subject knowledge and examination technique:

Specific Comments

Section A

Most candidates answered this section to a satisfactory standard. However, a significant proportion did not - with some obtaining a very small fraction of the 20 marks available. The questions continue to test candidates' knowledge across the range of topics included in the syllabus and good all round knowledge of these is required for candidates to ensure a satisfactory mark for the section. Candidates are reminded that the best technique to adopt when answering Section A questions is to work through them methodically in order, leaving any questions about which they are unsure and returning to them after attempting the later questions in the section. Candidates are also reminded that there is always a random pattern to the correct answer letters and frequency.

Section B

Question One

For a total of 15 marks over three parts, this question tested knowledge about internal control..

At part (a), for 3 marks, candidates were required to explain the meaning of the term "a deficiency in internal control", and in the main the quality of answers was inadequate with only relatively few making the connection with the explanation provided in ISA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, (and comprehensively covered in recommended texts). The requirement at part (b), offered 12 marks and tested knowledge on specific (i)authorisation, (ii) segregation of duties and (iii) physical controls, wherein candidates were asked to identify TWO policies or procedures that should exist for each in the subject company. A relatively large proportion of candidates listed only one policy or procedure for each and these were often incorrect or not precise enough for the full 2 marks. Others submitted two policies or procedures, but again due to incorrect knowledge or the provision of imprecise details, only a proportion of the marks were obtained. It was evident that at (ii) a lot of candidates did not appreciate the difference between "supervisory control" procedures and procedures that ensure the segregation of duties in a system.

Question Two

There were 15 marks available over four parts, testing aspects of audit risk and the audit risk model.

At part (a) a number of candidates were able to score 1 ½ marks of the 2 available, by defining audit risk as the risk that the auditor "expresses an inappropriate opinion on the financial statements" (or similar) - but only a minority of these obtained the extra ½ mark for clarification of the link with material misstatement. Most candidates scored at least ½ mark on this part, but given the fundamental importance of "audit risk" and the way it drives audit engagements, it was unsatisfactory to note the number of candidates that struggled with the concept.

Part (b) offered 2 marks for a definition of "detection risk" and whilst it was encouraging to see that a relatively high number could provide a sound definition (although some others incorrectly submitted that it

was the risk of the auditors procedures not “preventing” a misstatement), it was particularly unsatisfactory to note the significant minority of candidates that appeared to be totally confused by the term.

Almost inevitably part (c) of the question made reference to the two categories of risk that combine to determine the risk of material misstatement and 3 marks were available for identifying and explaining the concept of inherent risk, plus a further 3 marks for identifying and explaining the concept of control risk. In fairness most candidates identified each category (each worth 1 mark), but the range of definitions provided for inherent risk and control risk were mixed.. Candidates are again reminded that given the fundamental importance of “audit risk” generally and the relevance of the audit risk approach to audit engagements, the topic is likely to feature regularly in future FAU exams so it is imperative to have a very good understanding of the topic.

Part (d) required candidates to explain how the audit risk model should be applied in practice to achieve a prescribed level of audit risk. Relatively few candidates answered to a satisfactory standard with many scoring only 1 mark or less (of the 5 available).. Candidates clearly need to address this issue and ensure that they fully comprehend the application of the audit risk model.

Question Three

Over three parts, this question tested knowledge of specific methods of sample selection. It was answered to a relatively inadequate standard by a very significant number of candidates.

Part (a) offered 3 marks for an explanation of the random selection method. The important points to include in the answer were the fact that this method treats the subject population as a homogenous mass and that it relies on random number tables or computer generated random numbers to select a sample. A high proportion of candidates presented very brief answers - along the lines of “it’s where the auditor selects items randomly “ - for which no marks were awarded as this type of answer does not demonstrate any level of real understanding. At (b) for 3 marks, again a lot of candidates explained haphazard sampling as “ the auditor selecting items haphazardly “ (or similar) which proved little in terms of genuine understanding of the term. Answers to part (c), about systematic sampling, showed some improvement with a number of candidates appreciating the concept of selecting at pre - determined intervals based on population and sample size. Notwithstanding this, a significant number of candidates misunderstood that systematic sampling simply relied on a computer “system” to select a random sample.

Question Four

For a total of 10 marks over two parts, this question tested knowledge of the auditor’s report. The generally low level of marks awarded indicates that the majority of candidates have inadequate knowledge in this area.

Of all the requirements included in the paper, the requirement at part (a) was the most unsatisfactorily answered. For 1 mark each, candidates were required to (i) identify to whom the auditor’s report on the financial statements of a limited liability company should be addressed and (ii) by whom it should be signed. There were a number of candidates who could not answer these questions correctly.–At part (b), whilst a number of candidates were able to obtain at least 1 of the 2 two marks available for explaining the meaning of an unmodified audit report, other answers submitted for which no marks were awarded, other answers were brief and incorrect. Part (c) offered 6 marks for identifying and explaining any two of the four forms of modified audit opinions. The standard of the answers to this requirement was mixed.

Question Five

For a total of 6 marks, the question tested knowledge of an auditor's liability to third parties.

Candidates were required to identify and explain the three conditions (each for 2 marks), that must have existed for a third party to be successful in a negligence claim against an auditor. They are (i) a duty of care - enforceable by law, (ii) negligence – by the auditor in the performance of that duty, and (iii) monetary loss by the third party as a direct consequence of the auditor's negligence. In general candidates' answers fell into two distinct categories, being those that clearly displayed adequate level of knowledge on the topic and those that displayed inadequate level of knowledge. On the whole, the general standard of answers was unsatisfactory indicating that candidates had paid little attention to this area of the syllabus.

Question Six

For a total of 6 marks, the question tested knowledge of the audit of irrecoverable trade receivables, with a requirement to state just two procedures used to audit irrecoverable trade receivables (3 marks for each).

The question was answered to an unsatisfactory standard by the majority of candidates, with a large number displaying a lack of understanding of the most basic of substantive procedures as well as the objective of specified tests. A high volume of answers submitted made reference to analytical procedures without explaining how they could be applied to this audit situation. Many answers also comprised very brief comments such as "check for existence and ownership "(how?) and "check after – date receipts "(why?) or "check documents "(which? why?). Candidates should appreciate that such need explanation.

Question Seven

For a total of 6 marks, the question tested knowledge of the auditor's responsibility with regard to the disclosure of confidential information to a third party.

Answers to the requirement, to state three circumstances in which auditors may be required to disclose information to a third party or when such disclosures may be appropriate were mixed. The general standard of answers submitted was unsatisfactory with relatively few candidates providing three sound examples of relevant circumstances (2 marks available for each), and a large core providing unrealistic examples.

Question Eight

For a total of 6 marks, the question tested knowledge in the area of audit working papers.

The requirement was state three advantages of using automated working papers. A majority of candidates scored at least 2 marks by stating at least one advantage. A significant minority of candidates confused the term "automated " with "standardised" (in the context of working papers).

Question Nine

For a total of 6 marks over three parts, the question tested knowledge of external confirmations.

At part (a), 2 marks were available for explaining the term "external confirmation". Most candidates correctly stated that it was confirmation from a "third party " and obtained 1 mark for this, but only a minority went on to explain that it should be received directly by the auditor in written form. Again, at (b) a number of candidates scored at least 1 of the 2 marks available for explaining why external confirmations are deemed to be a reliable form of audit evidence. However at (c), a number of candidates could not obtain the full marks available for providing two examples of external confirmations. This was because a relatively high proportion of candidates provided incorrect examples in the form of bank statements and supplier statements.