



Examiners' report

F8 Audit and Assurance June 2008

Introduction

The examination consisted of five compulsory questions (Question 1 for 30 marks. Question 2 for 10 marks and three further questions of 20 marks each). 15 minutes reading time was provided at the commencement of the examination.

The vast majority of candidates attempted all five questions. Many candidates presented their answer to question 1 first, indicating appropriate use of reading time to prepare for the main scenario. However, a significant proportion of candidates answered questions in reverse order in this sitting (i.e. 5,4,3,2 and finally 1). These candidates, and those who attempted questions in a random order, normally struggled to obtain a pass standard.

Many candidates presented a high standard of answer for all five questions. The surprising lack of knowledge of controls testing (question 1b) did decrease the overall standard in this exam.

The inadequate performance of many candidates was once again exacerbated by a clear failure to carefully read the content and requirements of questions. This contributed to the continuing inadequate performance on narrative questions.

Too many candidates continue to display their answers inadequately, with a lack of clear labelling to indicate which questions are being attempted. Each question should be started on a new page and candidates must give more thought to the layout and organisation of their answers. Many scripts were also presented quite inadequately, with lengthy paragraphs of writing "hiding" many individual relevant points. Use of headings with short paragraphs is strongly recommended.

The paper did include a significant section on control testing in section 1b, which candidates historically find difficult. However, this was balanced by the inclusion of more theory questions than usual in questions 3 to 5 with candidates being able to show their knowledge of specific audit procedures in terms of analytical review (3a) and going concern review (5b).

As I said in my article in the April *student accountant*, having some practical knowledge of auditing will be beneficial to candidates taking this exam. However, a certain amount of knowledge can be obtained from theory and the exam is based to provide a mixture of theory and application questions. For the application questions, such as 1b and 4b, points to be considered and included in the answer will be in the scenario. It is therefore critical that candidates with no practical knowledge of auditing understand the technique of answering auditing questions to ensure that a pass standard is obtained.

Within each section below, indicative extracts from candidates answers are provided with commentary by the Examiner to show how those extracts could be improved.

Question 1

This question was based on a sales and despatch system, with the latter parts focusing on the audit of debtors/receivables. Of the various requirements, candidates were expected to use the scenario to provide relevant points in part (b), while the scenario also provided some support and ideas for other sections of the question. The use of CAATs was specifically excluded from this question to ensure that candidates focused on the manual elements of the various systems.

Question 1(a)

Candidates were required to explain the steps necessary to check the accuracy of the previous year's control questionnaires. To be clear, the question requirement was checking the accuracy of, not the specific content or

production of the control questionnaires. Most candidates recognised this distinction and provided some appropriate content on verifying that documentation. A minority of candidates proceeded to explain how the whole despatch and sales system could be audited. This approach was inappropriate for two reasons:

- Firstly, with only 4 marks available for the question, explaining how to audit an entire system would take much more than 4 marks.
- Secondly, explaining how to audit a system was not relevant to the question requirement of checking the accuracy of some documentation. Agreed, comparing the documentation to the actual systems was a valid point, but not a full repeat audit of that system.

The question was worth 4 marks. Most candidates provided between 2 and 4 points in their answers, with some candidates correctly explaining basic procedures like asking management for any changes in the systems and carrying out observation tests.

Example comments provided and reasons why those comments did not obtain a pass standard are noted below:

Answer comment

“The questionnaire does not need to be reviewed because systems have not changed”

Examiners assessment of comment

The scenario actually stated “as far as you are aware” the systems have not changed, indicating some uncertainty. Furthermore, just accepting prior year documentation without some basic checking to determine its accuracy is inappropriate as reliance would be being placed on essentially untested material.

Answer comment

“The most cost effective method of checking systems is the use of CAATs”.

Examiners assessment of comment

There may be some merit in the comment. However, as the scenario specifically ruled out the use of CAATs, the comment was not appropriate for this particular client.

Other common errors included:

- In a minority of situations, assuming that the client would produce and review the questionnaires. As with any audit documentation, it is the auditor who will obtain evidence on that item, not simply relying on the ability of the client.

This may not have appeared to be one of easiest introductory questions to an examination. The overall standard was just below the pass standard. Candidates are recommended where possible to use their basic auditing knowledge on verifying something to obtain marks in this type of question.

Question 1(b)

Candidates were required to use the scenario to list and explain the purpose of different tests of controls. The question was worth 12 marks. As the requirement explicitly stated that 6 tests were required, the marking scheme was 1 mark for the test and 1 for the explanation.

Some candidates provided normally brief and succinct answers, clearly identifying the tests of control and reasons for each test. However, many candidates did not seem to appreciate the difference between a test of control and a substantive procedure. A significant number of the points made were actually substantive procedures, which did limit the number of marks awarded for this section. This lack of knowledge was the main reason for the average mark in this section being far below a pass standard. Unfortunately, many candidates

appear to list every single substantive procedure they could think of, making so very long and largely irrelevant answers.

Example comments provided and reasons why those comments did not obtain a pass standard are noted below:

Answer comment

Inspect the goods received note (GRN) for signature from the customer. To confirm that the GRN are signed for completeness.

Examiner's assessment of comment

Does not state clearly what control the signature is achieving – in this case that the customer confirms that they have taken the goods listed on the GRN.

Answer comment

Test all orders, delivery notes and invoices to ensure the correct goods and amount has been recorded in the ledgers and correct invoice sent.

Examiner's assessment of comment

A poor procedure for the following reasons:

- It is not a test of control (which is the primary reason it is not relevant to this question requirement)
- It appears *all* documents will be tested – hardly ever the case
- It is not clear which system is being tested (which ledgers? What invoice?)

Answer comment

Review goods despatched notes to ensure they are dated and signed by the customer.

Examiner's assessment of comment

This comment is fine for stating the test of control – however, the second question requirement of explaining the reason for the test has not been mentioned. Marks would therefore be limited to 1 out of 2. An additional statement such as “to ensure that customer confirm receipt of goods stated on the GRN” would be needed to obtain the second mark.

Other common errors included:

- Stating weaknesses in the control systems, without mentioning any test of control. For example, stating “*all goods should be maintained on trolley before GDN is raised to ensure completeness of the GRN*”. This comment had no test of control or reason for the test and so was not relevant to the question requirement.
- Including comments on the debtors/receivables systems such as “*ensure that the aged debtors report is produced on a timely basis*”. The question requirement was for tests on the sales and despatch systems, not debtors.
- Providing detailed examples of substantive procedures. For example, “*Agree details on GDN to computer system*”. Marks would be obtained for listing an appropriate control such as the GDN being signed in the accounts department to confirm details had been entered onto the computer system.

Overall, the standard of answers was unsatisfactory.

Question 1(c)

Candidates were required to state and explain how audit assertions relate to the audit of debtors/receivables.

The question was worth 4 marks. As the requirement explicitly stated that 4 assertions were required, the marking scheme was 1 mark for each assertion. The mark was split for stating the assertion and explaining the relevance to debtors/receivables.

This question was difficult to set and to a certain extent to mark due to some imprecision in the ISAs themselves. In theory, a circularisation provides evidence on relatively few assertions. However, consideration of ISAs 500 and 505 shows that almost any assertion could be valid apart from normally presentation. Even the completeness assertion has some relevance where, for example, a receivable states that an item has been recorded in their books but this has been omitted from the client's books. Similarly, the valuation assertion is relevant where a circularisation reply is received from a receiver or liquidator of a receivable. The ISAs are also confusing regarding which assertions relate to the balance sheet – for example cut-off is identified under the class of transactions heading rather than a period end assertion – although it is generally tested at the period end.

Given paper F8 is not a technical paper (at least to this depth), the question was marked per the marking scheme – that is 0.5 mark for identifying the assertion and 0.5 for application to receivables. Candidates who made valid and plausible comments were therefore rewarded appropriately.

The overall standard for this question was relatively satisfactory; it was the application of the assertion that appeared to be problematic. Most candidates identified four assertions, but were unclear how this related to debtors/receivables.

Example comments provided and reasons why those comments did not obtain a pass standard are noted below:

Answer comment

Existence : this is to ensure that debtors exist and transactions has occurred. As such the debtor would confirm the amount owing in writing.

Examiners assessment of comment

There is some confusion regarding the assertion name and the one being explained. The answer starts by explaining existence – but then appears to get side-tracked into occurrence and valuation. It would have been better to note existence of the debtor is confirmed by the debtor replying to the confirmation letter.

Answer comment

Existence means that the debtor exists.

Examiners assessment of comment

The explanation of the assertion is taken as correct (the ISA actually uses the word “exist” to explain existence). However, there is no mention to show how the circularisation confirms existence – mentioning that receiving a reply from the debtors provides evidence of existence would obtain the full mark available.

Answer comment

Valuation – that amount has been appropriately disclosed in the accounts.

Examiners assessment of comment

Clear example of confusion between the assertion and the meaning of that assertion – nil points.

Other common errors in this section included:

- Explaining the assertion “measurement”. This is no longer a relevant assertion since the revision of ISAs 500/505 and so no marks could be awarded for points made regarding this assertion.

- Listing four assertions – literally giving four words. These type of answers did not either state what the assertion was or explain the relevance to debtors/receivables.

The standard of answer could have been higher; but overall candidates appeared to cope well with a difficult area of the study guide.

Question 1(d)(i)

Candidates were required describe the audit procedures leading up to the despatch of confirmation letters to debtors/receivables.

The question was worth 5 marks. There was no limit to the number of procedures that could be mentioned in the answer, although most candidates included five, showing an appreciation of the requirement and mark allocation. Most answers were clear and to the point. A minority of answers either mentioned other parts of the debtors circularisation or testing of the sales system, as mentioned below, which was not relevant for this specific question.

Example comments provided and reasons why those comments did not obtain a pass standard are noted below:

Answer comment

“When replies are received, confirm balance agreed to the ledger account and investigate any discrepancies.”

Examiners assessment of comment

The question requirement was to explain the debtors circularisation up to the despatch of letters to the debtor – audit work on replies was therefore not relevant to the requirement.

Answer comment

“Review of the sales and despatch system. For example agree details of sending goods despatch notes (GDN) to accounts department and ensuring that sales invoices area issued.”

Examiners assessment of comment

This is part of the sales system and therefore not relevant to the audit of year end debtors or the debtors circularisation.

Answer comment

“The computer system should produce a list of debtors.”

Examiners assessment of comment

While the comment is correct, it is difficult to see the audit procedure here. Stating a clear procedure such as “obtain the list of debtors, cast and agree to the year-end control account” would be a better answer and obtain the relevant mark.

Other common errors included:

- Mentioning other audit procedures on debtors such as reviewing after date cash to confirm that debtors had paid the year-end balance. While the procedures were normally valid, they did not relate to the preparation of the debtor’s circularisation and therefore did not gain any marks.
- Explaining audit work on the replies received from debtors. Again this was outwith the question requirement and so not relevant.
- Explaining how the debtors balances were accumulated in the ledger; that is how invoices, payments received and credit notes were posted into the ledger.

The overall standard of answers was high. However, a minority of candidates failed to focus on the preparation of the circularisation letters.

Question 1(d)(ii)

Candidates were required to discuss the categories of debtors that would be included in a debtors circularisation sample. The scenario did include an analysis of debtor balances which could be used as examples of the different categories of debtors – and many candidates focused their answer on this information. A minority of candidates stated other categories such as “material” or “potentially bad debts” ,correctly explained these and obtained similar marks.

The question was worth 5 marks. There was no limit to the number of categories that could be mentioned in the answer, although most candidates included up to five, showing an appreciation of the requirement and mark allocation. A significant minority of candidates spent the whole of the answer explaining one or two categories at the most, limiting the number of marks which could be awarded.

Example comments provided and reasons why those comments did not obtain a pass standard are noted below:

Answer comment

“Receivables more than 2 months old”

“Examiners assessment of comment

The answer does not state why these balances will be chosen – mentioning that the balances are more likely to result in bad debts and so confirm the bad debt provision obtains the full mark.

Answer comment

“Debtors purchasing more items towards the end of the year”.

Examiners assessment of comment

The issues here are how to identify these debtors from the listing and then why that specific category was relevant for the circularisation. Very clear points were needed to justify this type of comment, assuming that the selection could be justified.

Other common errors included:

- Focusing the entire answer on explaining how to extract a sample of debtors using some form of statistical sampling technique. While the marking scheme did allow some credit for this approach, the answer was effectively only explaining one categorisation method, which therefore limited the marks that could be awarded.
- Repeating the points made. In other words, a minority of answers provided little or no structure. Adequate answers tended to work down the categorisation presented in the scenario. Other answers tended to mention categories of debtors in a random order, sometimes duplicating categories of debtors, and then fail to mention why that category was to be chosen anyway.

The overall standard was satisfactory, where sufficient categories of debtors were mentioned in the answer.

Question 2(a)

In this knowledge question, candidates were required to explain the factors affecting the auditor’s decision on how much evidence to collect.

The question was worth 4 marks. The two requirement verbs of list and explain implied that four points were necessary to obtain full marks. For each point, 0.5 was allocated for identifying the relevant factor and 0.5 for

the explanation. Most candidates identified this split and provided four points, many using headings to help identification of those points.

Example comments provided and reasons why those comments did not obtain a pass standard are noted below:

Answer comment

“Third party evidence is more reliable than client evidence”

Examiners assessment of comment

This comment is correct to identify the point; stating why the evidence is more reliable e.g. mentioning independence, would help to obtain the second half mark.

Answer comment

“High-quality internal control systems”.

Examiners assessment of comment

Again, there is a lack of explanation to show how these affect the sufficiency of evidence. Stating that good internal systems decrease control risk and therefore the amount of evidence to collect would obtain the full mark.

Other common errors included:

- Writing far too much for each of the individual points. Given the marking scheme of one mark per point, one good sentence per point only was required to obtain the full mark. A significant minority of candidates provided a full paragraph of explanation per point made, which was simply not necessary. The learning point here is that briefer answers are acceptable as long as they are full sentences.
- Not providing sufficient breadth of answer. In many answers, a significant number of points were either repeated, or the candidate focused on reliability of evidence, which is only one aspect of sufficiency. Marking was relatively lenient in this area, but candidates provide a good breadth of comment (quality, risk, controls etc) generally obtained a higher standard of answer than those simply focusing on reliability.
- A minority of candidates explained the audit risk model for this section. While some credit could be given for inherent risk and control risk, this was not the case for detection risk. The latter is a result of assessment of the other risks and as such would not be controllable by the auditor in terms of evidence to be collected.

The overall standard was satisfactory.

Question 2(b)

In this knowledge question, candidates were required to list the possible contents of a management representation letter.

The question was worth 3 marks. The question had only one requirement verb, namely list. As six items were required in the answer, there was obviously six points to get worth 0.5 of a mark each. The verb list also implied literally listing the contents or headings of the letter. Most candidates followed this guidance and provided a clear list of management representation letter contents. A minority of candidates again provided lengthy answers which were simply not required in this question.

Example comments provided and reasons why those comments did not obtain a pass standard are noted below:

Answer comment

“Auditor states the nature of the control weakness”

“Examiners assessment of comment

This comment was indicative of confusion between a management representation letter and a management letter or letter of weakness. This was a common error in this question.

Answer comment

“Title, date, address of company, signature of director”.

Examiners assessment of comment

This answer was indicative of candidates not knowing the specific contents of a management representation letter. 0.5 of a mark was generally awarded for recognising that the letter came from the directors.

Other common errors included:

- As for 2a, writing too much
- Explaining the contents of other letters. In this respect, the engagement letter and management letter were listed by a significant minority of candidates.
- Including items in the answer that would not normally be included in a management letter. For example, calculation of accruals and prepayments or confirmation of a bank balance.

As with part (a) of this question, the overall standard was reasonable.

Question 2(c)

In this knowledge question, candidates were required to explain the actions that the auditor could take following errors found in control testing. Most candidates recognised that control testing by itself is not sufficient to support the audit opinion and therefore mentioned extending substantive procedures as an action that could be taken. Substantive procedures were not explicitly mentioned in the question to avoid giving away what should be a basic point regarding obtaining audit evidence.

The question was worth 3 marks. The requirement verb was explained with the question also stating that three actions were required. There was therefore one mark for each action. A sentence giving that action would therefore attract the mark. Most candidates did provide up to three actions, showing that the question had been understood.

Example comments provided and reasons why those comments did not obtain a pass standard are noted below:

Answer comment

“Perform substantive procedures”

“Examiners assessment of comment

While correct as an action, this comment did not explain why those procedures were necessary. Mentioning that additional audit procedures were necessary to alleviate the control breakdown would show that the candidate understood the need to extend substantive procedures.

Answer comment

“Extend audit testing to use analytical procedures to identify the control weakness”.

Examiners assessment of comment

The idea of extending audit testing is correct. However, the use of analytical procedures is inappropriate because this form of testing will not provide the detail necessary to show control weaknesses or indeed the extent of monetary error, if any in this case, that substantive procedures will provide.

Other common errors included:

- Not mentioning the need to discuss matters with management or the audit committee. A significant minority of answers simply extended audit testing and then suggested a qualification in the audit report.
- Suggesting actions that were probably inappropriate at the time. The most common action suggested in this sense was immediate resignation. This was inappropriate because many other actions (discussion with management etc) would be taken prior to this.
- Explaining every type of audit report modification, rather than providing a systematic approach of extending testing, reporting to management, etc. prior to mentioning some form of modification could be required depending on results from substantive procedures.

Again with this knowledge question, the overall standard was satisfactory.

Question 3(a)

In this question, candidates were required to explain analytical procedures, give examples of the types of procedures that could be used and finally the situations in the audit when analytical procedures could be used. This was a purely knowledge based question providing a relatively lengthy, but hopefully straight-forward introduction to the main application type section of this question.

The question was worth 8 marks. The requirement verb was explained indicating, with the lack of scenario, one mark per point made. Most candidates recognised the mark allocation and divided their time accordingly. A minority of candidates tended to repeat the same or very similar points in each section of the answer, but the overall standard was satisfactory.

A “typical” candidate obtained:

- 1 mark for section (i), with the explanation being limited to providing an overview of analytical procedures,
- up to three marks in (ii) where good examples of different procedures were given. The most common list being comparison within one year, comparisons to different industries and “proof of total”, and
- between 2 and 3 marks for (iii). The marks obtained in this section depended more on provision of examples of the three sections of the audit rather than actually identifying those sections in the answer.

Example comments provided and reasons why those comments did not obtain a pass standard are noted below:

Answer comment

“The main types of substantive procedures include test of control and CAATs”

Examiners assessment of comment

This comment was indicative of a minority of answers which appeared to show inadequate knowledge on this important audit area. The answers provided a lot of detail on control testing and CAATs but really nothing on analytical procedures. Very few or sometimes zero marks were obtained for these answers.

Answer comment

“Analytical procedures can be used at the end of the audit as part of risk analysis.”

Examiners assessment of comment

The place for using analytical procedures is correct. However, the comment “as part of risk analysis” appears out of place or simply not sufficiently well explained. Stating that end of audit analytical review helps compare the auditor’s overall knowledge of the business with the financial statements would be appropriate.

Other common errors included:

- Explaining different methods of collecting audit evidence such as enquiry, computation, observation, etc. These methods of collection are not analytical procedures and therefore did not obtain any marks (part (ii)).
- Re-iterating examples of collecting evidence in part (iii) of the question. The answer needed to focus on the three stages of the audit.
- Not providing sufficient breadth of examples. A minority of answers listed the same analytical procedures for each section of the balance sheet (fixed assets, debtors, creditors etc.). These answers were generally “capped” regarding the marks awarded as “different types” of procedure per the question requirement were not being provided.

Overall, the standard of answers was reasonable. However some answers did not provide the necessary breadth of comment or simply omitted sections altogether, presumably due to lack of knowledge.

Question 3(b)

In this question, candidates were required to identify and try and explain unusual changes in the income statement. An income statement was provided in the scenario, with what were hopefully some fairly obvious changes that should make an auditor question the accuracy of the figures. The comment that the directors thought the company had had a difficult year, but the results appeared to be good was supposed to elicit this questioning attitude towards the income statement.

Many candidates did question the figures in the statement, as far as considering the possibility of window-dressing or fraudulent activity given the directors’ initial comments. However, many comments made only basic comments such as “sales have increased” which was really self-evident from the scenario. Inadequate answers also typically covered a very limited range of points. Candidates needed to realise that because some very basic information was provided that, finding problems with that information should be relatively straight forward.

The question was worth 9 marks. The requirement verbs were identify and explain indicating, with the scenario, that identify was probably .5 mark and explain provided a further mark. Six good points would therefore provide full marks. While basic calculations were helpful, these should not have taken very long. It was evident that many candidates did not have a calculator although the examiner has noted that questions required basic calculations can be set in this paper.

Example comments provided and reasons why those comments did not obtain a pass standard are noted below:

Answer comment

“An increase in turnover shows that sales have increased.”

Examiners assessment of comment

The answer does not really explain why turnover has increased – sales and turnover being the same thing. Valid explanations for increase in turnover include more marketing, changes in weather (perhaps more sunny days meaning people were outside more in their gardens, cheaper shed prices increasing demand, etc.)

Answer comment

“Selling and distribution costs increased by 20%.”

Examiners assessment of comment

This comment is correct regarding identifying a movement in an item of expenditure. However, reasons for this change are not mentioned. Linking the change to the sales increase – which was not in proportion to selling and distribution costs, to identify a potential problem would have been appropriate. Similarly, suggesting reasons for

distribution costs increasing from general knowledge would also be correct; many candidates noted that increase in fuel prices worldwide would have increased distribution costs for many companies.

Other common errors included:

- not understanding basic accounting principles meaning that some explanations were strange or in some cases simply incorrect. For example, simply stating that sales had increased because more goods were being sold on credit compared to cash (debtors may increase due to this mix change, sales would not unless linked to better credit terms being provided). Also, cost of sales falling due to stock being undervalued....
- Lack of structure or format to answers. Very few answers followed the structure of the income statement, but tended to make points in almost any order (e.g. selling costs, cash, cost of sales, etc.). This meant that there were serious omissions from most answers regarding the changes between the two years; following the format of the income statement would have to alleviate this error.
- Providing excessive detail on the cash and bank balances. The question requirement specifically mentioned the income statement; the cash balances were included to demonstrate that the interest paid and receivable may be suspect. Detailed speculation on why the bank balance had improved was therefore not required.

Overall, the standard of answers was unsatisfactory. Many candidates provided very brief answers with little or no explanation for changes in the income statement.

Question 3(c)

In this question, candidates were required to explain the procedures to obtain a bank confirmation letter. The question was essentially to use the final three marks of the question on a (hopefully) straight-forward area rather than provide more detail for the section (b) scenario.

The question was worth 3 marks. The requirement verb was explained indicating, with the lack of scenario, one mark per point made. Again, most candidates recognised this and provided three, but sometimes more, procedures.

The overall standard was adequate. The main reason for an inadequate answer was a candidate explaining how to perform a bank reconciliation, rather than obtain the bank letter.

Example comments provided and reasons why those comments did not obtain a pass standard are noted below:

Answer comment

“Decide whether to perform a positive or negative letter and obtain client approval accordingly”

Examiners assessment of comment

While obtaining client approval was important, bank confirmations are “positive” in that a response is expected.

Answer comment

“Obtain the cash book, trace all deposits to the bank statement and cheques issued to the suppliers ledger accounts.”

Examiners assessment of comment

This comment relates more to testing of transaction systems and is therefore not relevant to obtaining a bank letter.

Answers from a number of jurisdictions indicated that the auditor would visit the bank to obtain the letter rather than use the postal service. This appeared reasonable as it meant that the letter would go direct to the audit rather than the client.

Overall, the standard of answers was reasonable.

Question 4(a)

In this question, candidates were required to discuss the advantages and disadvantages of outsourcing an internal audit department. This was a knowledge based question; there was no scenario, so candidates were expected to use their knowledge of internal audit and outsourcing to write their answer. The requirement verb “discuss” indicated that points had to be identified and then explained in the context of outsourcing. Many candidates recognised this requirement and provide eight well explained points. However, many other candidates did not link their comments to outsourcing, which limited the number of marks which could be awarded.

Marks were not “capped” between advantages and disadvantages, so in theory a candidate could obtain eight marks from simply discussing the advantages of outsourcing. In practice, most candidates mentioned at least two disadvantages, although disadvantages were sometimes more difficult to identify and discuss.

Example comments provided and reasons why those comments did not obtain a pass standard are noted below:

Answer comment

“Potential reduction in cost.”

Examiners assessment of comment

Worth 0.5 at best because there is no explanation of why cost will decrease. “Potential reduction in cost because recruitment fees and training costs will be avoided” would be worth the full mark

Answer comment

“The internal audit department will be able to provide detailed reviews of the control systems in the company and recommendations for improvements in those controls.”

Examiners assessment of comment

While correct, this comment is true for any internal audit department. Answers needed to focus more on the outsourcing element of internal audit, not simply generic benefits of internal audit.

Answer comment

“An outsourced internal audit department will be more independent”

Examiners assessment of comment

Agreed – but why is this? Asking this question could elicit the answer “because they don’t work full time at the company and have fewer self-interest or association risks”. Ensuring all comments are explained again helps to pick up easily the full mark per point made.

Other common errors included:

- Not linking the points made to outsourcing internal audit. Many comments made were generic; that is they could apply to any internal audit department. To gain full credit, comments had to relate to outsourcing.
- As noted above, not fully explaining the points made.

Overall, the standard of answers for this question was high indicating that candidates did understand the theory behind the question.

Question 4(b)

In this question, candidates were required to discuss the reasons for and against having an internal audit department in a specific company. A scenario was therefore provided for the question. The scenario contained many “clues” as to why an internal audit department would be useful (or not) and candidates were expected to identify those points and make specific reference to them in their answers.

The question was worth 12 marks. The requirement verb discuss indicated that some comment was needed to show why the points made were relevant. The marking scheme allowed one mark for mentioning the specific area and a second mark for applying this to the scenario. Many candidates recognised this requirement and provided six well-explained comments to obtain 12 marks. Other candidates did not relate their comments to the scenario at all, which limited the number of marks obtainable per point to 1.

Example comments provided and reasons why those comments did not obtain a pass standard are noted below:

Answer comment

“To examine financial and accounting information.”

Examiners assessment of comment

This is a reason for having an internal audit department; however, it is not clear why this function is necessary in this specific situation. Specific reference should be made to the issue of the non-qualified financial accountant and the potential need to review accounts in case accounting standards have not been applied correctly. The comment at present could attract 0.5 mark; with full explanation and linking to the scenario the full 2 marks would be obtained.

Answer comment

“Montehodge is a family owned company with four of the six shareholders being board members.”

Examiners assessment of comment

The statement is correct; although it is simply a repeat of information provided in the scenario. To gain any credit the reason why this relates to the use of an internal audit department must be explained. For example, the issue of lack of protection for the remaining two shareholders could be mentioned and that internal audit would provide them with some confidence regarding the controls and financial statements of the company.

Answer comment

To evaluate and test the design and implementation of controls at Montehodge Co.

Examiners assessment of comment

This is one of the reasons a company would establish an internal audit department and so the comment is valid. However, there is no reference back to the scenario to show why the controls need testing. Mentioning issues such as lack of controls (directors trusting staff) or the fact that the company has 15 locations and therefore needs a common control system would provide the necessary additional detail in the answer to gain the application mark.

Other common errors included:

- Not linking the points made to the scenario. As mentioned above, this limited the number of marks available per point to 1.
- Not fully explaining the points made. Brief comments such as “internal audit would be expensive” only attracted 0.5 of a mark. Additional detail to show why internal audit was expensive and why it was expensive in the situation of the scenario.

Overall, this section, along with (a), provided the best standard of answer for any question in this examination. Part (b) particularly catered for candidates who had good theoretical knowledge of internal audit (obtaining 1 mark per point) and candidates who had the ability to apply their knowledge to a scenario (and obtain 2 marks per point made). A significant number of candidates obtained more than 15 marks from this question, enabling them to pass the examination overall.

Question 5(a)

In this question, candidates were required to define going concern and discuss auditors' responsibilities with respect to going concern.

The question was worth 4 marks. The first requirement verb define implied that a basic statement of going concern was needed, probably for one mark. The second requirement verb of discuss, without a scenario, indicated that three points were needed; one mark per point. A minority of candidates did obtain two definition points by linking their definition to the ISA, although in common with other questions in this exam, there was no need to state the ISA number.

Most candidates identified the mark allocation, although only managed to provide one auditor responsibility. The average mark for this question was therefore two. Very few candidates mentioned responsibilities such as reporting to members or discussing the going concern concept with the directors.

Example comments provided and reasons why those comments did not obtain a pass standard are noted below:

Answer comment

"Going concern means that the company will be in existence for the unforeseeable future."

Examiners assessment of comment

This was a very common comment. The term unforeseeable was normally allowed on the assumption that candidates are unclear of the exact English here.

Answer comment

"The auditor is responsible for ensuring that the company will be a going concern by producing cash flow forecasts and other documentation to prove this."

Examiners assessment of comment

No – the auditor reviews information provided by the directors. The responsibility is to test the going concern assumption, not "prove" that it is correct; in theory the auditor can never be 100% sure that the assumption is correct anyway.

Other common errors included:

- Stating lots of audit procedures that the auditor could carry out. While the auditor is responsible for reviewing the going concern assumption, how the auditor obtains evidence to meet that responsibility is a different issue and therefore not relevant to this particular question. Candidates are advised to read all of the question requirements initially – part (b) would then be identified as the section requiring audit procedures on the going concern concept.
- Stating that it was the auditor's responsibility to prepare financial statements on the going concern basis. This is not the case, the auditor has a responsibility to audit the financial statements, not prepare them.

Overall, the standard for this question was average only due to the lack of explanation of auditor responsibilities.

Question 5(b)

In this question, candidates were required to state the audit procedures that an auditor can carry out with respect to the going concern assumption.

The question was worth 8 marks. The requirement verb was simply state, indicating that all the candidate had to do to obtain a mark was state a relevant procedure. With eight marks available then eight relevant procedures would provide maximum marks. Most candidates recognised the requirement, although a significant minority lost time in their answer by providing lengthy introductions to the work of the auditor.

Audit procedures mentioned in the answer could be relevant to the scenario – various factors were mentioned to provide “clues” again to the relevant points to make an answer. However, many going concern procedures are generic to all companies, and candidates could still obtain easy marks by mentioning these e.g. reviewing cash flow forecasts or obtaining representations from the directors.

Example comments provided and reasons why those comments did not obtain a pass standard are noted below:

Answer comment

“Check whether any more employees have left the company.”

Examiners assessment of comment

The candidate has correctly identified one of the problems from the scenario in that a key employee has left the Smithson company. However, it is not clear from the answer what the actual audit procedure is; the word “check” being relatively vague. It would have been better to suggest that the auditor should discuss the replacement of key employees with the directors, or the HR department, rather than simply “checking”.

Answer comment

“Key employees leaving the company”

Examiners assessment of comment

This is actually an indicator of going concern, not an audit procedure. As such, it is not worth any credit. To gain a mark, an audit procedure, as suggested above, had to be stated.

Other common errors included:

- Providing a list of going concern indicators rather than audit procedures. The question requirement was for the audit procedures – that is the actions that the auditor will take. Listing indicators such as “key employees leaving the company” does not state what the auditor will actually do and therefore no credit can be given.
- Not providing sufficient detail on each procedure. For example, the procedure “review board minutes” is insufficient for a full mark because it is not clear why the minutes are being reviewed or when the review takes place. Stating that the minutes will be reviewed for going concern indicators for board meetings after the year end provides the necessary detail.
- Listing audit work on the financial statements. This is a very common error with going concern questions – candidates repeat the audit work already carried out (e.g. carry out a debtors’ circularisation) rather than looking for procedures relevant to the future of the company.

A minority of candidates provided eight relevant procedures and obtained full marks from this question.

However, many other answers did not state the procedures clearly or simply mentioned only two or three procedures. Many candidates therefore did not answer this question well.

Question 5(c)

In this question, candidates were required to explain the audit procedures that could be carried out on the assumption that the company being audited would not be a going concern.

The question was worth 4 marks. The requirement verb explain indicated that answers should provide some element of detail to show why the procedure was being carried out. As information was not now available from the scenario, then one mark per point was available.

This question proved to be difficult for many candidates. Many comments made were repeats of the audit work already carried out in part (b) of the answer, while others attempted to explain every possible type of audit report that could be produced. While the latter approach had some merit, few candidates mentioned the basic procedures of discussing the situation with directors or obtaining a letter of representation point.

Example comments provided and reasons why those comments did not obtain a pass standard are noted below:

Answer comment

“Obtain a management representation point.”

Examiners assessment of comment

This is a valid procedure, although there is no “explanation” as such as to what the point is or why it is being obtained. Stating the point was being obtained to confirm the directors view on going concern would help to provide the necessary explanation.

Answer comment

“Qualify the audit report by unmodifying the opinion with an emphasis of matter opinion.”

Examiners assessment of comment

Some modification of the audit report would normally be expected in a going concern situation. However, the words used are a jumble of potentially relevant terms. To obtain a mark a clear statement of the amendment to the audit report was necessary.

Other common errors included:

- Repeating audit procedures from part (b) of the question. This was not required as the auditor had made a decision regarding the going concern concept. These comments also duplicated those from part (b); the examiner does not normally ask the same question twice in one examination.

A minority of commercially aware candidates also suggested that the auditor needs to raise a fee note as soon as possible, presumably to ensure that audit fees were paid prior to the company going into liquidation.

The standard of answers was therefore unsatisfactory for this section. The standard of answers again demonstrates that candidates do not like making decisions at the end of the audit (a weakness common to questions on events after the balance sheet date).

Question 5(d)

In this question, candidates were required to define negative assurance and then explain how this differs from assurance on an audit report.

The question was worth 4 marks. In line with requirement (a), the definition was worth a mark with additional marks available for explaining the difference between the two types of assurance.

Many candidates managed to produce a basic definition of negative assurance although there remained some confusion regarding the difference between this and assurance given on an audit report. The main weakness was using the term true and fair view in the context of an assurance engagement with only a minority of candidates recognising that truth and fairness relate to statutory audit. A significant minority of candidates did not attempt this question, presumably due to time allocation problems at the end of the examination.

Example comments provided and reasons why those comments did not obtain a pass standard are noted below:

Answer comment

“Negative assurance means that the cash flow does not present a true and fair view.”

Examiners assessment of comment

As noted above, negative assurance needs to be linked to lack of knowledge of material error, not true and fair view.

Other common errors included:

- Repeating audit procedures on going concern. As for requirement (c), these were relevant to part (b) of this question.

The standard of answer was therefore inadequate.