



# Examiners' report

## F8 Audit and Assurance December 2007

The examination consisted 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. Candidates who attempted questions in a random order, and question 1 last, normally struggled to obtain a pass standard.

Many candidates presented a high standard of answer for all five questions,. However, there was again evidence of different standards indicating where additional work and study time and/or assistance is required.

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.

Workings were generally shown but were at times difficult to follow. Too many candidates continue to display their answers poorly, 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. Valuable time can be easily wasted, for example by not tabulating the answer to Question 3(b).

### Question 1

This was a 30 mark question and the rationale behind providing this small case study was two-fold:

- Firstly, to provided candidates with experience of attempting longer questions in preparation for the significant case studies that will be found in the professional level papers.
- Secondly, to allow the examiner to effectively combine two 20 mark questions to use one scenario rather than two. The aim being to cut down the amount of reading and assimilation time candidates need to understand a question prior to preparing an answer.

Given the overall higher standard of answers in this exam, the second objective at least appears to have been met; whether the first has been achieved will depend on results to the Professional papers in future diets.

The scenario itself was based on a computerised procurement and purchases system and the work of an auditor in attending the inventory count at a client. The purchases system was deliberately based on a computer system, in line with the comments made by the examiner in the study guide and at the 2007 lecturers' conference. As in similar paper 2.6 examinations, candidates were expected to use the information in the scenario to provide relevant comments in their answers.

### Part (a)

Candidates were required to use information concerning the purchases system provided in the scenario.

The question was worth 12 marks, requiring the candidates to list audit procedures and then explain the reason for each procedure. The marking scheme was clear; six procedures were required with the procedure itself being worth 1 mark and the explanation of a procedure also being worth one mark. To obtain full marks candidates needed to provide six procedures meeting this criterion.

Pass standard candidates provided between four and six good procedures, with some explanation of each procedure. However, only a minority of candidates demonstrated a good understanding of audit procedures and the reasons for those procedures.

Many candidates struggled with the scenario, particularly regarding the use of the purchases system and partly in respect to the computerisation of that system. Candidates who recognised that basic audit procedures such as tracing information through a system or ensuring that details were recorded in specific ledgers or books did obtain a pass standard.

Common errors and reasons why those errors did not obtain marks included:

| Error  | Reason for lack of marks   |
|--|--|
| Testing the controls over the computer system such as passwords and backup systems   | These were tests of the general controls over the computer rather than tests on the purchases system.  |
| Procedures relating to the payment of suppliers including recording of transactions in the cash book and supplier ledger accounts  | These procedures related to the payments systems not the purchases systems. If the distinction was not clear to the candidate, payment systems were not mentioned within the scenario indicating that comments in this area were not relevant.   |
| Procedures relating to cut-off.  | This assertion relates to year-end testing of stock and purchases. The scenario was dated prior to the year-end making these comments not relevant.  |
| Just stating an assertion word as a reason for performing a procedure.   | This was generally not sufficient for an answer as it was not necessarily clear that the candidate understood the assertion, and in many cases stating an incorrect assertion. Providing a few words of explanation e.g. "confirming occurrence of purchases by agreeing purchase invoice details to the delivery notes, provided useful and relevant explanation. |
| Writing out what the purchase system should do without actually stating any audit procedures. For example, stating that for all goods received there should be a three part delivery note raised. These comments showed good knowledge of systems but not of audit procedures. | No marks could be awarded because no audit procedure was actually stated. Mark earning comments would include observing the goods receipt system to ensure that goods receipt notes were raised, or reviewing a sample of goods receipt notes to ensure they were signed to confirm receipt of goods etc.  |

Other answers failed to provide sufficient detail to obtain either the procedure mark or the explanation mark.

Many candidates also continued to "check" documents rather than actually show clear what procedures were. For example, typical comments in this respect were:

- Check the invoice
- Check the goods received note
- Check return of goods.

Unfortunately, it was not clear exactly what was being checked or why; more detail was needed to earn the procedure mark. For example, *obtain details from a sample of purchase invoices and agree these to the purchase day book and ledger* would form a valid procedure.

Regarding the explanation mark, many candidates correctly attempted to link audit procedures to the audit assertions. However, the quoting of assertions was not always clear or accurate. For example:

- Suggesting that agreeing purchase order details to the inventory ledgers confirmed the completeness of invoices – when the correct assertion was occurrence.
- Tracing details from the delivery note to the purchase order to confirm correct valuation of the invoice – the completeness assertion would normally be used here.

Finally, many comments related to procedures that either could not be carried out or were simply incorrect. For example:

| Example “procedure”  | Problem with “procedure”   |
|--|--|
| Agreeing details from the purchase invoice to the goods held in the inventory store. | There are two problems with this comment: Firstly, goods received notes are normally used to update inventory, not purchase invoices. Secondly, it would be virtually impossible to agree details to the goods held – as the parts, etc. would have been used during the year in the manufacture of the items produced by the company. |
| Agreeing individual items of physical inventory to the goods inwards documentation   | Again, agreeing physical goods to the goods inwards documentation would be impossible – as noted above, the goods would be included in items manufactured by the company.  |
| Tracing details of orders to the purchase day book.                                  | Orders are normally agreed to the delivery notes, not the purchase day book. The latter is for recording the purchase invoices. So agreeing orders to purchase day book is not possible.   |

Overall, the standard of the answers for this basic auditing question was disappointing. Candidates and tutors are reminded of the importance of understanding sales, purchases and similar systems and the need to be able to provide clear audit procedures and explanation for those procedures. This will remain a key element of the audit and assurance examination.

### Part (b)

Candidates were required to list four audit procedures that the auditor would perform prior to attending the inventory count at a client.

The marking scheme for this question was therefore 0.5 mark for each procedure. The key difference between this sub-question and part (a) being the lack of need to relate those procedures to the scenario and therefore the award of 1 mark per point.

Candidates tended to obtain either full marks or zero marks for this question, depending on whether or not they had read the question requirement correctly. The key word in the requirement was *prior*; a significant minority of

candidates missed reading this word and listed procedures relevant to actually attending the inventory count; these procedures were unfortunately not relevant.

Other common errors and reasons why those errors did not obtain marks included:

| Error  | Reason for lack of marks  |
|--|---|
| Not stating the procedure in sufficient detail | It was unclear what the procedure aimed to do. For example, <i>contact client</i> was insufficient for a procedure whereas <i>contact client to obtain inventory count instructions</i> was sufficient. |

While not an error as such, many candidates wrote significant amounts of text in providing an answer to this section, in some cases easily exceeding one page of writing. Given that only four procedures had to be listed, this amount of writing was clearly inappropriate. Candidates and tutors need to understand that the requirement verb list is simply that; no explanation of the individual procedures was required to obtain the 0.5 mark for each procedure.

### Part (c)

Candidates were required to list the weaknesses in the control system for counting inventory at one of the client depots and then explain the weakness and state how the weakness could be overcome. In other words, the question was based on a letter of weakness, although the specific format for that letter was not required.

While not completely transparent, the marking scheme followed the convention of parts (a) and (b). The requirement verb was “list” indicating that simply the weakness was required to obtain a mark. In this case three procedures would provided the full 3 marks for sub-question (i) as those procedures had to be related to the scenario, as in part (a). This meant that there were 3 marks for each section in (ii) to explain the weakness (1.5 marks) and state how the weakness could be overcome (again 1.5 marks). A candidate providing valid weaknesses, with an explanation and method of overcoming that weakness could obtain full marks. The scheme was possibly generous in allowing 1.5 marks for explanation and recommendation.

In practice, most candidates provided more than three weaknesses with some explanation and methods of overcoming each weakness. As the question requirement did not place any cap on the number of weaknesses that could be mentioned in the answer, all valid weaknesses were marked. This scheme allowed many candidates to obtain full marks in this section with most candidates deserving those marks as many clear and well thought out comments were made.

For the future, where letter of weakness type questions are allowed, a cap will be placed on the number of weaknesses allowed to provide a clear and transparent guide to candidates.

As already noted, the overall standard of answers to this section was high. The identification of weaknesses and how to respond to those weaknesses had clearly been well learned/taught enabling candidates to provide sound answers. The difficulty for many candidates appeared to be simply when to stop writing as the scenario did include six or seven key weaknesses where marks could be obtained. Following the published guidance from the examiner in this respect in the Examiner’s Approach may have helped provide this guidance.

Common errors and reasons why those errors did not obtain marks included:

| Error  | Reason for lack of marks   |
|--|--|
| Not linking the explanation of the weakness to the weakness itself. For example, stating that the count sheets were completed in pencil and then stating that this did not provide an adequate segregation of duties.      | To obtain the reason marks there had to be a clear link between the weakness and the reason for that weakness. For example, where count sheets were recorded in pencil then the weakness was those sheets could be amended easily to show incorrect inventory quantities – and there would be no record of that amendment. |
| Not linking the method of overcoming the weakness with the weakness itself. For example, stating that the count sheets were completed in pencil and then indicating that all sheets should be signed by a senior official. | To obtain the method of overcoming the weakness marks there had to be a clear link between the weakness and the method of alleviating that weakness.   |
| Not necessarily thinking about the practicality or realism of the comments being made. For example, stating that the auditor would assign count teams to different areas of the depot.                                     | In practice, the auditor is there to observe the inventory count, not organise it. Marks were generally not awarded where comments did not relate to the auditors' standard work.  |

Overall, the question was well answered, with almost all candidates correctly using the information in the scenario .

#### Part (d)

Candidates were required to state the aim of a test of control and substantive procedure and then to provide examples of those tests/procedure with reference to inventory count attendance.

The marking scheme for this question was simply 1 mark for each explanation and 1 mark for each test/procedure. As in parts (a) and (c), the test/procedure had to be linked to the specific scenario, hence 1 mark was available for each test/procedure rather than 0.5.

This question turned out to be an unusually good discriminator of candidates. Many candidates obtained full marks, clearly demonstrating their knowledge of tests of control and substantive audit procedures. However, a significant minority of candidates either did not attempt the question or scored zero points due to poor and incorrect explanation and examples.

Common errors and reasons why those errors did not obtain marks included:

| Error  | Reason for lack of marks  |
|--|---|
| Explaining substantive audit procedures as being used when tests of controls were not available or had failed. | While the reason for using substantive procedures may have been partly correct, the reason for the procedure in terms of validating balance sheet assertions was not mentioned. |

|   |   |
|---|---|
| Explaining tests of controls as substantive test and substantive tests as tests of controls. For example, stating that ensuring all count sheets were signed was a substantive test or agreeing the quantities of inventory to the inventory ledgers. | No marks could be awarded because the example was incorrect.  |
| Providing examples not relevant to the inventory count, for example, confirmation of balances in the suppliers' ledger or other substantive tests on purchasing system.   | The question requirement clearly stated examples had to be provided from the inventory count, therefore these points were not relevant. |

## Question 2

This type of question was again new to the examining of audit and assurance. The reason for the question being linked to question 1. Under the "old" 2.6 syllabus, many questions had brief short introductory sections followed by the longer scenario based questions. With the new F8 examination taking question 1 as the scenario, this meant that question 2 was based on the shorter introductory sections. Questions could therefore range from between 2 and 5 marks and be based completely on theory. As noted below, understanding the distinction between the requirement verbs of list and explain/describe is essential to providing the correct format and detail in an answer.

### Part (a)

Candidates were required to explain the five fundamental principles of ACCA's Code of Ethics and Conduct.

The requirement verb for this section was *explain*. So the marking scheme for this question was simply 1 mark for each point; effectively 0.5 for identifying the fundamental principle and 0.5 for the explanation. In other words, listing the principles was not sufficient to obtain a pass – explanation was also required.

Answers to this question varied considerably. A significant number of candidates obtained full marks by correctly listing and explaining all five principles. However, a significant minority either did not attempt the question or provided incorrect examples.

Common errors and reasons why those errors did not obtain marks included:

| Error   | Reason for lack of marks  |
|---|---|
| Including principles that were not in ACCA's list. The main example of this was "independence" although a small minority of candidates included the standard threats to independence such as self-review and self interest. | These points were not relevant and so no marks could be awarded.  |
| Not providing sufficient explanation of the points made. For example, explaining <i>integrity</i> as the <i>an accountant must have integrity</i> .   | To gain more than 0.5 of a mark, then integrity had to be explained in other terms rather than simply restating the term. |

Overall, the question was answered well.

### Part (b)

Candidates were required to explain the actions that an auditor should carry out to ascertain whether an entity if a going concern.

The requirement verb for this section was *explain*. So the marking scheme for this question, as for part (a) was simply 1 mark for each point; effectively 0.5 for identifying the action and 0.5 for the explanation.

Answers to this question also varied considerably. A significant minority of candidates correctly explained actions in respect of going concern and obtained the full 5 marks. However, other answers stated very few actions or simply did not explain the actions.

Common errors and reasons why those errors did not obtain marks included:

| Error   | Reason for lack of marks   |
|---|--|
| Stating going concern indicators rather than actions to take in respect of going concern. For example, listing indicators such as falling profits or key staff leaving rather than explaining the action. | The list of indicators did not show sufficiently well that the candidate actually understood the action to take. For example, key staff leaving may be a problem for the company. However, to gain credit this point needed to be linked to the skills lost and the impact on the ability of the company to trade, not simply that staff were leaving. |
| Explaining actions that had little or no relevance to work on going concern. For example, reviewing past financial statements or calculation of ratios based on historical information.                   | These actions focused on the historical information provided by the company, and not the forward-looking information necessary to determine the going concern status of the client.  |
| Explaining the process of and the types of audit report relevant to the going concern assumption.   | The process of audit report production is not part of the work of determining whether or not an entity is a going concern. In other words, report production itself does not provide audit evidence on the going concern assumption.   |
| Providing detailed lists of going concern indicators but not information concerning what the auditor would actually do with those indicators. For example, stating "key staff leaving".                   | Additional information was needed to show what the procedure was e.g. "ascertain from the human resources department how many and which staff had left the company to determine whether there are skills shortages in key areas such as research and development.  |

### Question 3

#### Part (a)

Candidates were required to explain issues that could limit the independence of the internal audit department in a company and then recommend a way of overcoming that issue. Candidates were provided with information in a scenario with specific reference in the question requirement to that information. To obtain credit, answers therefore had to relate to information presented in the scenario.

The requirement verbs for this section were explain and recommend. Candidates were therefore expected to find the issues limiting independence and explain each issue for 1 mark. For each issue a recommendation on how to overcome the issue provided the second mark.

To obtain the full two marks per point, answers would normally take the format “*issue 1 could limit independence in Matalas, because.... . This issue can be overcome by... .*” However, as the question requirement did not specify the number of points to make, then any number of valid points could be included in the answer. Most candidates included four fairly well explained points in their answer. A minority of candidates provided limited or no explanation of the points made, limiting the marks awarded.

Common errors and reasons why those errors did not obtain marks included:

| Error   | Reason for lack of marks  |
|---|---|
| Including points in the answer which were not mentioned in the scenario. A minority of candidates mentioned generic reasons why internal audit may not be independent.  | These points were not relevant and so no marks could be awarded.  |
| Including points which although could be relevant to the scenario were not necessarily best practice. For example, in many internal audit departments the chief internal auditor is involved in appointing staff because they can identify the skills required and whether that person is suitable to work within the department.                       | These points were not fundamental flaws limiting the independence of the internal audit department.   |
| Including points on petty cash weaknesses.  | These were relevant to section (b) of the answer.   |
| Not explaining the reason for the weakness. For example, a common comment was <i>the chief internal auditor reports to the finance director</i> . While this was correct in relation to the question, the reason in terms of lack of independence of reporting or the finance director suppressing adverse reports on his department was not explained. | To obtain the 0.5 mark for explaining the weakness, the explanation as noted on the left had to be provided.  |
| Stating changes to take place within the company without justifying why that change was necessary. For example, stating an audit committee was needed.  | The method of overcoming weaknesses (an audit committee being one) had to be linked to a weakness identified in the scenario. Simply stating areas of good corporate governance was normally insufficient as the reason for the suggested change was not clear. |
| Mentioning that the internal audit department had only six internal auditors limiting their independence.   | The number of staff may have limited the department's effectiveness, but not necessarily their independence.  |

Overall, the candidates answered this question well.



**Part (b)**

Candidates were required to explain the weaknesses in the petty cash system of Matalas and then recommend a control to overcome that weakness.

The requirement verbs for this section were again explain and recommend. Candidates were therefore expected to find the control weaknesses in the petty cash system and explain each issue for 1 mark. For each issue a recommendation on how to overcome the issue provided the second mark.

To obtain the full two marks per point, answers would normally take the format “*issue 1 is a petty cash weakness in Matalas, because..... . This weakness can be overcome by...*” However, as the question requirement did not specify the number of points to make, then any number of valid points could be included in the answer. Most candidates included up to six fairly well explained points in their answer. Again, a minority of candidates provided limited or no explanation of the points made, limiting the marks awarded.

The most interesting point to mark in this question concerned the location of the petty cash box itself. Almost all candidates recognised that it was inappropriate to maintain the petty cash book in public view on a bookcase, with the reason that the box could be stolen easily. However, controls over this weakness varied from simply keeping the box in a safe to using CCTV and employing security guards to ensure the box was not stolen. Given the (relatively) small amount of money in the box, some controls did appear excessive. However, they were normally marked as valid as certainly in some jurisdictions the control could well be appropriate.

Common errors and reasons why those errors did not obtain marks included:

| Error   | Reason for lack of marks   |
|---|--|
| Not explaining the reason for weaknesses identified. For example, many candidates noted that petty cash was counted by the cashier – but not the weakness that the cashier could report incorrect cash balances and steal some of the money.  | 0.5 of a mark per point could not be awarded because the reason for the weakness was not explained.                              |
| Suggesting weaknesses that were not mentioned in the scenario. The most common weakness in this respect was the comment that petty cash should be computerised.   | To gain full marks, the weakness had to be clearly related to the information provided in scenario.                              |
| Suggesting many and sometimes completely impractical procedures for the control of petty cash. For example, suggesting that all petty cash vouchers had to be signed by the senior accountant or that a voucher should be signed by one person, recorded in the petty cash book by another and then a third person dispensed the actual cash. | Awarding marks in these situations was limited because the controls were simply not practical or cost effective for any company. |

A significant number of candidates struggled to provide sufficient reasons. The overall standard was satisfactory which was possibly more an indication that candidates were not always familiar with petty cash systems but that they could identify and comment on weaknesses.

## Question 4

### Part (a)

Candidates were required to explain audit procedures using audit software that could be used on receivables balances and then to explain the reason for each procedure.

The requirement verbs for this section were explain and then explain again. The emphasis on explain in this section was to highlight to candidates that it was necessary to show clearly why procedures were being used, not simply to list procedures. Linking comments to the use of audit software was also critical in this section and candidates were expected to select procedures that could be carried out using that software.

Some comments therefore identified audit procedures such as a receivables circularisation, showed how audit software could be used to select specific balances for circularisation and potentially produce letters to be sent to those receivables, and then explain the reason for that procedure in terms of audit assertions. Some comments identified the need for a receivables circularisation but did not show how audit software assisted with this procedure and did not link the procedure to audit assertions.

Candidates could obtain the 9 marks on offer by explaining five procedures. As with many other questions there was no limit to the number of procedures that could be mentioned.

Common errors and reasons why those errors did not obtain marks included:

| Error   | Reason for lack of marks  |
|---|---|
| Focusing answers on the use of test data. For example, explaining procedures such as inputting test data into the receivables system in an attempt to break credit limits.  | The question referred to the use of audit software, not test data.  |
| Explaining points on the audit of sales. For example, suggesting that audit software could check the accuracy of the casting of sales invoices.                             | The question focus was on the audit of receivables, not sales. Therefore audit procedures should be focused on this area such as casting the list of receivables, not invoices.   |
| Explaining procedures to test the program controls. For example, explaining how the computer systems at the client should have passwords to control access.                 | These points were simply not relevant to the question, which was focused on the use of audit software, not the testing of controls over the clients systems.  |
| Explaining tests using manual systems, for example, stating that a receivables circularisation would be carried out without reference to how the audit software could help. | Procedures had to focus on the use of audit software. So in this case, mention should be made of use of the software to select specific balances for circularisation and quite possibly the production of letters to be sent to the individual receivables. |
| Structuring answers around the different types of audit evidence that could be collected e.g. enquiry, observation, etc.  | This was inappropriate as these types of evidence could not be collected using audit software. For example, audit software cannot enquire of directors whether there are any irrecoverable debts.   |

Many answers also provided lists of procedures with little or no explanation for those procedures

The overall standard for this section was inadequate. The majority of candidates failed to obtain even basic marks for casting the receivables ledger or performing some initial analytical review of balances. Most answers focused on manual systems or the audit of sales, as noted above. The key point to remember from the question is that detailed knowledge of how Computer Assisted Audit Techniques (CAATs) work is not required, as the study guide for this paper states. However, that does not mean questions using CAATs will not be asked in the exam. Basic knowledge of audit procedures possible with CAATs, as shown in this question, is an exam requirement.

**Part (b)**

Candidates were required to explain the problems of using audit software at a specific client and also to explain how to overcome each problem.

The requirement verbs for this section were explain and then explain again. The emphasis this time to warn candidates that problems had to be identified from the scenario, and that solutions had to be relevant to each problem and hopefully realistic.

Comments therefore identified problems such as copy files being provided by the client for the auditor may not contain complete data, because of poor systems or possibly lack of experience on the part of client staff. A realistic solution was therefore for the auditor to verify the copying process. However some comments mentioned that use of audit software was expensive, but did not state why this was the case or provide a solution such as deferring use of software until the client implemented a new system allowing a longer period of time for implementation payback.

Candidates could obtain the 8 marks on offer by explaining four problems and solutions. As with many other questions there was no limit to the number of procedures that could be mentioned.

Common errors and reasons why those errors did not obtain marks included:

| Error  | Reason for lack of marks  |
|--|---|
| Stating general problems with the use of audit software without reference to the scenario. For example, stating that using audit software was expensive.   | These comments provided candidates with some 0.5 marks as the problem was valid. Additional detail such as the expense of recording old systems or the lack of time for payback given the imminent system change were needed to obtain full marks for the point made. |
| Stating problems with the use of audit software but not providing valid methods of overcoming each problem. For example, stating that client staff provided the auditor with copy files, and then suggesting that the files could be incomplete due to taking the copy prior to the end of the year. | This comment provided a reason for the incomplete file, but not a solution. To obtain full marks for the point, additional comment was needed for example, showing how the auditor would verify the copying process.  |
| Many candidates suggested that a major problem with using audit software was that client staff had not used the software before and so they needed training.   | Audit software is used by the auditor, so this comment was not relevant.  |

As for part (a), the standard for this section was inadequate. Many answers were brief and failed to relate points to the scenario itself. As indicated above, some standard candidates tended to state points clearly and succinctly, gaining marks quickly. Other candidates tended to provide relatively long and unfocused answers, indicating lack of knowledge in this area.

### Part (c)

Candidates were required to explain the concept of auditing “around the computer”.

Unfortunately, this issue did not appear to be understood by the majority of candidates. Most answers focused on explaining how CAATs were used in auditing computer systems or how auditors could still use entirely manual audits but without reference to the risk of reliance on (untested) computer systems. However, some useful diagrams explaining the process of audit around the computer were provided showing that the term was known.

Candidates could obtain the 3 marks on offer by explaining the term in the question and then giving examples of the risk of auditing around the computer.

Common errors and reasons why those errors did not obtain marks included:

| Error  | Reason for lack of marks  |
|--|---|
| Explaining the audit risk model.   | The question requirement was to explain why audit risk increased, not to explain the risk model itself. These comments were therefore not relevant to the question being asked.   |
| Explaining how CAATs could be used to audit computer systems.  | While most of these answers were factually correct, they explained how a computer system was audited, not the lack of auditing of that system. The points made were therefore not relevant to the question.                                   |
| Explaining how an auditor performs a manual audit by printing out all the data from the computer system. | Some comments here were getting close to the issue of over-reliance on the computer system. However, the overall approach taken was to ignore the computer completely rather than stating the risk of reliance on data from untested systems. |
| Suggesting that auditing around the computer meant looking at computer controls only.                    | This is not the case; auditing around the computer means almost exactly the opposite of this with computer controls not being tested.   |

Again, the standard of answers was inadequate.

### Question 5

#### Part (a)

Candidates were required to explain how they would attempt to resolve an outstanding issue at the end of the audit. The question requirement included the terms “audit procedures” and “actions” to elicit comments such as discussing the matter with the directors, which may not be seen as a clear procedure.

The requirement verb for this section was “state”. In other words, this was a difficult question and the examiner was looking for valid procedures and actions without any detailed explanation as to why those procedures were being carried out. Providing six valid procedures/actions would therefore enable a candidate to obtain full marks. Obviously, the procedure/action had to be relevant to the scenario.

The short scenario also included the phrase “the audit work has been completed, but there is one outstanding matter” to indicate that audit work was literally complete apart from this matter. The focus of answers had therefore to be on resolving this matter, not on reperforming earlier audit work.

Most candidates focused their answers on the additional audit work. A minority did re-audit buildings in their entirety and normally failed to address at the end of each answer the issue of lack of depreciation.

Common errors and reasons why those errors did not obtain marks included:

| Error   | Reason for lack of marks  |
|---|---|
| Explaining in detail how to audit buildings, including procedures such as verifying title and determining existence by seeing the buildings.  | The focus of the question was on the issue of lack of depreciation, and not the general audit work on buildings.                                    |
| Not providing sufficient breadth of comments. Most candidates mentioned the need to communicate with the directors and amend the audit report in some way. However, other points such as comparing the proposed accounting treatment to GAAP were mentioned only in a minority of answers.  | The marking scheme was one mark per procedure/action. Lack of breadth obviously limiting the marks that could be obtained.                          |
| Confusion regarding the type of audit report to be provided. In this section, as in part (b), it was obvious that audit reports and specifically modifications/qualifications had not been taught or understood. The range of comments was considerable ranging from a “qualified report – except for”, which was a possibility, to an “adverse report, not modified with an emphasis of matter”. | The audit report type has to be clear to avoid confusion. Where candidates applied terminology incorrectly, marks could not be awarded.             |
| Considering resignation from the audit assignment before other procedures/actions had been attempted.   | Given the question stated that there was only one matter outstanding, resigning prior to attempting to remedy the issue was taken as inappropriate. |
| Stating procedures/actions that could not be performed e.g. arranging a meeting of members.   | These actions showed a lack of knowledge of appropriate law or auditors rights. Marks could not be awarded.   |

|  |  |
|--|--|
| Providing significant amounts of detail on the accounting treatment of depreciation. | While comments of this nature were factually correct, this is an auditing examination. Detailed explanation of how to apply accounting standards are therefore not required. Comments of this type are relevant to papers F3 and F7. |
|--|--|

The overall standard for this section was satisfactory. The majority of candidates did obtain marks for contacting the directors, determining the materiality of the situation and considering the effect on the audit report.

### Part (b)

Candidates were required to explain the meaning and purpose of five different extracts from an audit report.

The requirement verb for this section was explain; along with the two key terms of meaning and purpose for five extracts the marking scheme was clear; five points with two marks each.

Some candidates recognised this split and provided two paragraphs for each of the five extracts. Other answers tended to focus on the meaning of the extract with little or no comment on the purpose of that part of the report.

To be clear, the distinction between meaning and purpose should be as follows; “meaning” related to explaining the extract while “purpose” to stating why the extract was in an audit report. Many candidates struggled to explain why the extracts were included in an audit report.

Common errors and reasons why those errors did not obtain marks included:

| Error   | Reason for lack of marks  |
|---|---|
| Taking each audit report extract as a separate opinion paragraph and explaining it in terms of “emphasis of matter”, or different types of qualification. | This was inappropriate; the question stated these were extracts from an audit report (singular), not separate reports. Taking each extract as a separate report also showed a lack of knowledge of audit reports themselves. Taking this approach severely limited explanations as candidates tended to focus on explaining modifications/qualifications, and not the actual meaning and purpose of each extract. |
| Explaining paragraph 5 was an unmodified audit report.  | This was not the case; an explanation of the report in terms the modification made was needed.  |
| For various paragraphs, stating that the report was produced for the benefit of the management.   | This comment showed a lack of understanding of the purpose of audit reports and had to be (not) marked accordingly.   |
| Not explaining the meaning of each report extract.  | Answers tended to focus on explaining the purpose of each paragraph; omitting the meaning limited the number of marks that could be awarded.  |

The overall standard for this section was satisfactory. However, along with question 2a, the question also identified a lack of basic knowledge. Candidates and tutors are again reminded of the importance of being able to explain audit reports clearly in the context of this examination.

**Part (c)**

Candidates were required to explain the effect of two different situations on an auditors' report.

The short scenario presented two situations, with key terms embedded in the scenario, with the requirement to state the effect on the audit report. The marking scheme was therefore clear; four marks for two requirements gave two marks per requirement.

For part (i), candidates were expected to recognise that lack of depreciation, turning a profit into a significant loss, had a significant impact on the audit report. An adverse report was expected for a pervasive situation.

For part (ii), candidates were expected to recognise that not attending the inventory count resulted in uncertainty, but inventory was only material to the financial statements. An "except for" qualification was therefore expected.

Common errors and reasons why those errors did not obtain marks included:

| Error  | Reason for lack of marks   |
|--|--|
| Not stating the effect on the audit report. Many answers tended to focus on the problems inherent in each situation including whether the company was a going concern (for situation (i)) and whether the auditor could re-count inventory now for situation (ii).   | The question requirement was to state the effect on the audit report, so comments along these lines were not relevant and did not obtain marks.  |
| Confusion regarding the terminology of the effect on the audit report. As in part (b) extract 5, there were some interesting and varied comments regarding the type of audit report to produce. The most common mistake was to qualify with an emphasis of matter closely followed by the unmodified adverse report. | The permutations on audit reports showed a lack of understanding in this key area. Marks could only be awarded where the terminology was used correctly.   |
| A significant number of answers suggested additional audit work or amendments that could be made to the financial statements.  | These comments were not appropriate because, as the question stated, it was the effect on the audit report that now had to be stated. The question followed the practical situation that an auditor will face – eventually no more evidence can be obtained and a decision must be made on the content of the report itself. |

Answers varied in standard.