



# Examiners' report

## F8 Audit & Assurance

June 2009

### General Comments

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. A significant number of candidates answered questions in reverse order in this sitting (i.e. 5,4,3,2 and finally 1) or attempted question 2 first, leaving question 1 to the end of the examination. These candidates, appeared to encounter significant time pressure at the end of the examination, with question 1 rarely being completed. The pass rate for these candidates was also lower than those where question 1 was attempted first.

Many candidates presented a high standard of answer for all five questions. Question 1 (a) and (c) appeared to be the most challenging as the subject matter appeared to be less well understood.

The inadequate performance of many candidates was once again exacerbated by a clear failure to carefully read the requirements of questions and note the time allocation indicated by the marks to be awarded. Of significant concern this diet was the lack of clear time allocation in question 2. As noted above, many candidates answer this question first and wrote a significant amount of detail on each section (in many cases more than question 1). Given that question 2 had only 10 marks available and question 1, 30 marks, there was a clear lack of examination technique in using the time available to maximise mark earning potential.

As in previous diets, 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. This was particularly relevant in questions 3a(ii) and 4 which clearly lent themselves to use headings for clear presentation. Use of headings with short paragraphs is strongly recommended.

### Specific Comments

#### Question One

This question was based on a sales system in a theme park. Candidates were expected to use information in the scenario for all sections of the answer apart from section (a).

#### 1a

Candidates were required to list and explain the main sections of an audit strategy document and then provide an example of that section from the scenario provided in the question.

The question was worth 8 marks. A significant number of candidates did not appear to be aware of what an audit strategy is. Many candidates did not even attempt the question. Of those candidates attempting the question, answers tended to fall into two main categories:

- Firstly, setting out sections of the strategy, and providing clear examples. Answers in this category included candidates who were not clear of the actual headings of the strategy, but even so attempted to think "big picture" about the audit and make comments accordingly. For example, candidates were aware that setting out audit procedures were important for planning and attempted to explain the approach to sales testing even if the reason for this was not specifically mentioned. These answers were usually satisfactory.
- Secondly, focusing on the detail of the audit. Answers in this category listed income, expenditure, asset and liability headings and then attempted to show the detailed testing required for each section. While

comments made were normally correct, the lack of focus on the overall audit approach limited the marks that could be awarded. This type of answer was unsatisfactory.

Most candidates provided a list of controls, although a minority did provide significant explanation of the controls; detail that was not needed for this answer.

Other common errors included:

- Not linking points made to the scenario. For example, mentioning the need to determine risk and materiality but then not mentioning key risk areas such as cash sales.
- Lack of breadth of points made. For example, mentioning scope and direction of the audit but not risk, materiality, assessment of control systems, etc.

A minority of candidates performed satisfactorily, with a significant minority not attempting the question at all. The overall standard was therefore inadequate.

### **1b**

Candidates were required to identify risks that could lead to sales and cash receipts being incomplete and then discuss how tests of control and substantive procedures could be used to confirm the assertion of completeness.

The question was worth 10 marks. Part (i) was worth 4 marks; candidates providing 4 relevant points linked to the scenario obtained these marks. Part (ii) was worth 6 marks with the discussion requirement verb indicating that comment was necessary on how effective tests of controls and substantive procedures were in an environment where cash was used extensively.

Part (i) was generally answered well with many candidates being quite realistic and/or inventive regarding how either cash could be stolen or visitors to the park obtain entry without paying. As well as points mentioned in the marking scheme, more innovative comments including ticket staff giving away free tickets to family members and two security guards being insufficient to guard the cash (apparently two guards collude to steal cash whereas three would not?).

A minority of answers tended to focus on control weaknesses without actually stating how this affecting completeness of income. For example, answers could mention a control weakness was not reconciling tickets sold to cash received without specifically stating that an error would indicate tickets had been “sold” for no income, which affected the completeness assertion.

Part (ii) was almost always answered inadequately. Almost all candidates appeared to see the words “*tests of controls and substantive procedures*” and therefore provided a long list of possible tests of control and substantive procedures on the sale system. Unfortunately, the question requirement was “*discuss the extent to which tests of control and substantive procedures could be used to confirm the assertion of completeness of income...*”, a completely different question. In other words, the question was asking for some commentary on the effectiveness of audit testing in a cash based environment focusing on areas such as the need for clear segregation of duties and authorisation of cash/ticket reconciliations in the company to be confirmed in tests of control. Only a minority of candidates read the question correctly and made this type of comment. The overall standard for this question was inadequate.

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

#### **(i)**

##### **Answer comment**

Cash might not be received at all.

##### **Examiner’s assessment of comment**

Not sufficient to link to the scenario, more detail on why cash would not be received as in ticket clerks giving away free tickets, was needed to obtain the mark.

**Answer comment**

Security guards do not sign to show how much cash has been received for transfer to the accounts office.

**Examiner's assessment of comment**

This is a control weakness. However, the issue with completeness is that guards could steal cash as the total has not been confirmed; the answer needed to mention this weakness to obtain full credit.

**(ii)**

**Answer comment**

Trace cash receipts from the ticket office to the accounts office and subsequent recording in the cash book.

**Examiner's assessment of comment**

This comment has the makings of a substantive procedure. However, there is no comment on how effective the system is to make the procedure effective.

As noted above, the main error was simply mis-reading sub-question (ii). The warning for candidates is not to dash into what appears to be an easy question but to read the requirement carefully to ensure the question set by the examiner is actually being answered.

Overall, candidates performed well in (i) but inadequately in (ii).

**1c**

Candidates were required to list substantive analytical procedures that could be used to give assurance regarding total income firstly for one day and then for one year, using the information from the scenario.

The question was worth 8 marks. The question requirement was for two sets of procedures, as noted above. As procedures were linked to the scenario, a list of 8 procedures would be sufficient to obtain 8 marks. There was no mark split between the two sub-sections hence marks could be obtained to the maximum amount in either section; most candidates split answers roughly between the two sub-sections, which was expected.

The main weakness in many answers was the lack of discrimination between substantive procedures and substantive *analytical* procedures. Almost all answers included one or more pure substantive procedures with a minority focusing on this type of procedure to the exclusion of analytical procedures. In other words, many comments related to the substantive testing of the cash receipts system including counting cash in the tickets offices through to confirming the amounts recorded in the cash books to the bank statements. While these procedures were not incorrect in themselves, they were not analytical procedures required by the question.

Regarding analytical procedures, most candidates managed to compare daily/yearly income with other days/years as well as budgets, forecasts and other similar theme parks. Only a minority used other information in the scenario such as comparing ticket receipts to gift shops sales. Overall results in this section were therefore varied.

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

**Answer comment**

"Trace total receipts in the cash book to the bank statement for a number of days."

**Examiners assessment of comment**

The answer is a substantive procedure rather than a substantive *analytical* procedure. The point is therefore not relevant because the question requirement has not been met.

**Answer comment**

“Compare total daily income from all ticket offices”.

**Examiners assessment of comment**

The point appears to be an analytical procedure; however, it is not clear what comparison is being made. Additional detail showing the income from each office was being compared to other offices to identify unusual discrepancies would help the candidate obtain the mark available.

The standard of answers for this question was mixed, as noted above. Many candidates did not distinguish between substantive procedures and substantive *analytical* procedures as in December 08 question 1. However, it was pleasing to see some very clear answers to this section, obviously drawing on the learning experience from the December paper.

**1d**

Candidates were required to explain audit procedures on the credit card receivables balance.

The question was worth 4 marks. Therefore including 4 relevant procedures in the answer would obtain all marks on offer. Most candidates mentioned 4 (or sometimes fewer) procedures although a minority mentioned more than 4.

Most candidates appeared to understand the question and provided an appropriate range of procedures. In other words, even though the concept of a credit card receivable may have been unfamiliar, candidates were able to apply their knowledge to the audit of receivables in general terms and therefore mentioned relevant procedures such as direct confirmation using after-date receipts to confirm year-end balances.

The main weakness in many answers was the confusion between the audit of sales and the audit of receivables. A significant minority of candidates explained how the total sales figure could be audited, for example, testing receipts through the sales day book to recording in the sales ledger. While answers were factually correct, they did not relate to receivables testing and could not therefore be awarded credit.

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

**Answer comment**

“Check the receivables figure in the financial statement.”

**Examiners assessment of comment**

The audit procedure is not clear – the use of the term “check” almost always causing this weakness. Check the figure to what – why?? A clearer procedure such as “obtain the year end list of receivable balances, cast the list and agree the total to the general ledger and financial statements” was required here.

**Answer comment**

Post the totals from the sales day book to the sales ledger.

**Examiners assessment of comment**

While there is some benefit in the procedure, it did not relate to the audit of year end receivables and was therefore not relevant to the question requirement.

Other common errors included:

- Listing the methods of collecting audit evidence such as inspection and enquiry.
- Listing audit assertions for receivables without linking these to valid audit procedures.

The standard of answers tended to be varied. Inadequate answers tended only focus on sales procedures, with satisfactory standard answers focusing on procedures relevant to receivables.

## Question Two

### 2a

Question 2a was worth 4 marks and required candidates to explain four methods of obtaining a sample of items to test from a population.

Most candidates provided up to four methods, and a significant minority obtained full marks. There were two overall weaknesses in many answers:

- Firstly, not explaining the method of sampling, or explaining the method incorrectly. For example, stating that statistical sampling meant that the auditor used judgement to determine which items to sample.
- Secondly, listing general methods of collecting audit evidence (enquiry, computation, etc) as methods of obtaining audit samples.

In summary, the question was well-answered.

### 2b

Question 2b was worth 4 marks and required candidates explain four audit assertions relevant to the recording of classes of transactions.

Most candidates provided four, valid points; however, there was significant confusion regarding which assertions related to classes of transactions even though study material and ISA 500 clearly make that distinction. The use of general memory joggers such as CODRACE appeared to work against candidates for this question with many assertions such as rights and obligations being incorrectly included in answers. The term “measurement” was also still being used even though this is no longer relevant to ISA 500.

There were two overall weaknesses in many answers

- Firstly, not mentioning classes of transactions assertions as noted above.
- Secondly, not providing a valid explanation of each assertion. Many assertions were explained using a key term from another assertion; for example, “occurrence means that the transaction has been completely recorded”. These answers gain 0.5 marks for stating a correct assertion but no 0.5 mark for the explanation. Many assertions were also explained using the assertion term only; for example, “completeness means the transaction is complete”. In this case additional detail was almost always needed to show that, in this case, completeness meant all transactions within that class had been recorded.

In summary, the question was relatively well answered.

### 2c

Question 2c was worth 2 marks and required candidates to explain the term “modified”.

Most candidates appeared to understand that modified meant that an audit report was not “clean” or “standard”. Types of modification including emphasis of matter and qualifications of limitation in scope and disagreement were then explained.

However, there were two overall weaknesses in many answers:

- Firstly, the assumption that a modified report meant that a previous audit report had been amended due to events after the reporting period occurring. The “old” report had effectively been recalled and “modified”.

- Secondly, explaining modified in terms of emphasis of matter only; whereas modified can also include a qualified report.

One other concern was the minority of candidates who provided a page or more of answer for what was only 2 marks. Those marks were normally obtained within the first paragraph meaning the rest of the answer was not required. In this situation, poor examination technique led to time pressure later in the examination.

In summary, the standard of answer was unsatisfactory due to the confusion about this straight-forward auditing term.

### **Question Three**

#### **(i) AND (ii)**

Candidates were expected to explain the benefits of using audit software and the problems in a specific audit where using audit software was one of those problems.

The question was worth 14 marks. Part (i) was worth 4 marks; candidates explaining 4 benefits obtained full marks. Part (ii) was worth 10 marks with the more complicated requirement to explain problems and then show how each problem could be overcome. The general marking guide for this question is 0.5 marks for identifying the problem. 0.5 mark for explaining it and finally 1 mark for showing how it could be overcome. A candidate explaining 5 problems would therefore obtain full marks.

Most candidates provided sufficient points in their answers; although a minority spent too much time on (ii) by including up to 8 or 9 points; marks in this situation had to be capped at the stated 10.

In part (i), most candidates demonstrated basic knowledge of the use of audit software explaining the “standard” benefits of time, cost, use of actual data in the computer etc. A few candidates made some good links to the scenario, for example, explaining how data could be amalgamated to avoid having to visit the 25 branches in the company.

In part (ii), again most candidates provided a range of valid points and obtained decent marks. However, common weaknesses in this section included:

- Not explaining had to overcome the weakness either by omitting this comment or by making unrealistic comments. For example, in terms of potential damage to client systems from the use of test data suggesting the weakness would be overcome by “being careful” or in a handful of answers by simply not accepting the audit engagement.
- Suggesting weaknesses that were not mentioned in the scenario. For example, suggesting that inventory valuation would be difficult as experts on car parts were difficult to find, or that the auditor had to attend all 25 locations simultaneously to prevent the client double counting inventory in more than one location.
- Recommending amendments to the client systems for other perceived weaknesses. For example, stating that a distributed processing system was not appropriate for the client and recommending a centralised system instead. Even if this was a recommendation to the client, it would not affect audit planning now and so was not relevant as a current audit problem.

Example comments provided and reasons why those comments did not obtain a pass standard are noted below (for part (ii)):

#### **Answer comment**

“The audit cannot obtain sufficient information on the client’s system in the time allowed and so should resign.”

#### **Examiners assessment of comment**

The answer has started to identify a weakness although this is not clearly explained. However, the solution of resigning the audit is not really acceptable as the client has only just been accepted; other methods of overcoming the problem such as careful planning, use of experienced staff or approaching the client for an extension of the audit deadline are more relevant.

#### **Answer comment**

“Inventory must be valued at the lower of cost and net realisable value. To overcome this problem the auditor must attend all 25 inventory locations.”.

#### **Examiners assessment of comment**

The inventory valuation method mentioned is correct; however, there is no indication in the scenario that inventory valuation is a problem. The fact that the auditor must attend all 25 locations also does not overcome this problem; attendance at inventory count is more concerned with existence while valuation focuses more on cost and sales evidence.

The standard of answers for this question was satisfactory.

### **3b**

Candidates were required explain how documentation produced by internal audit would be evaluated prior to placing reliance on that documentation.

The question was worth 6 marks. The marking scheme allowed for 1 mark for each point made. Most candidates obtained a marginal result explaining either how the internal audit department itself could be relied on or the documentation; only a minority of answers mentioned both. Marks were generally obtained from:

- Considering the work of internal audit in areas such as experience in computer systems, and quality of documentation provided, and
- Testing the documentation itself for example, in comparison to the actual system using walk-through or similar testing methods, or obtaining advice from external specialists.

There were relatively few less relevant points in this section. The main area of weakness related to candidates spending too much time explaining the appointment and general work of internal audit rather than placing reliance on this function.

The overall standard of answers was fair. A clear pass standard was obtained where both reliance on internal audit and testing the documentation was mentioned; marginal results tended to focus on too few relevant areas.

### **Question Four**

#### **a**

Candidates were required to contrast the role of internal and external auditors.

The question was worth 8 marks. Candidates could therefore obtain full marks by identifying four areas to contrast internal and external auditors against (for example, who they reported to) and explain that different in their answer. Many candidates provided this type of answer, many using a columnar format, which made for clear presentation and clarity of marking. A significant number of candidates obtained full marks for this question. Inadequate answers tended not to provide a clear contrast between the two sets of auditors or be presented as a one long paragraph making individual points difficult and sometimes impossible to identify.

Common errors included:

- Including points which did not appear to be relevant to the role of internal or external auditors. For example, the appointment of the auditor did not appear to affect what the auditor did, although the person the auditor reported to was relevant as this determined the format of report.

- In some situations, not explaining the points made. For example, stating that both sets of auditors were responsible for detecting fraud, without then going on to explain that the main responsibility rests with internal audit while external audit is concerned with material fraud only.

Overall, answers to this question were of a high standard with many candidates obtaining 8 marks.

#### 4b

Candidates were expected to discuss the benefits of forming an audit committee using information from the scenario to support their comments.

The question was worth 12 marks. Given that the question contained a scenario, and the requirement verb was discuss, candidates could expect up to 2 marks per point made; 1 mark for explaining the benefit of an audit committee and 1 mark for showing how this applied to the scenario. In some answers, this marking guide was recognised and some satisfactory answers showing how an audit committee could assist the company in the scenario were produced. Many answers, however, tended to list the benefits of an audit committee with little or no reference to the detail in the scenario. These answers still obtained 1 mark per point for identifying and explaining the benefit and obviously needed double the number of points to obtain full marks.

The standard of answer was satisfactory. Many candidates obtain a clear pass standard,

The main weakness in many answers was explaining the constitution of the audit committee or the work of other committees rather than the benefit of an audit committee.

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

#### **Answer comment**

“The audit committee will comprise non-executive directors (NEDs) who will review the work of executive directors ensuring they are working in the best interests of shareholders.”

#### **Examiners assessment of comment**

This is not a benefit of internal audit, but a general comment on why NEDs are expected in a company. The point is therefore not relevant to the question asked.

#### **Answer comment**

“The audit committee and assess the need for new directors on the board of Conoy, such as the finance director, and assist in identifying and recruiting those directors”.

#### **Examiners assessment of comment**

The point would be correct, if it related to the nomination committee. However, as the question relates to benefits of the audit committee, the point is again not relevant.

Overall, this question was answered well. The question obviously benefited those candidates who could apply knowledge to a scenario (therefore explaining 6 points for 12 marks) and those who had good knowledge (explaining 12 points for 12 marks).

### **Question Five**

#### **a**

Candidates were required to list audit procedures and actions in respect of the director’s decision to revalue some inventory to a potentially unrealistic amount.

The question was worth 6 marks. As the requirement verb was list, then including 6 relevant procedures in the answer would obtain full marks.



This question proved to be a fairly good discriminator with many candidates struggling to obtain more than 3 marks overall. The majority of answers explained the need to discuss the matter with the directors, the effect on materiality and the need to modify the audit opinion to obtain these marks. Some answers went on to mention other points such as representation letters and reviewing the proposed policy against GAAP to see if it actually was valid.

The main weakness in many answers concerned the apparent need to go back and audit inventory from the beginning of the audit, even though the question requirement clearly stated that audit was complete apart from this issue. Audit procedures regarding existence (seeing the inventory), obtaining the government contract to determine the need to hold 6,000 barrels of oil, etc were therefore not relevant to the answer. A minority of candidates also treated the issue as an event after the reporting period and moved on to discussing the going concern status of the company. As no inventory had actually been destroyed, these comments were again treated as not relevant.

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

**Answer comment (part i)**

“Verify that the inventory of oil exists by attending the client and using a dipstick to check the level of oil in the tank.”

**Examiners assessment of comment**

Potentially a good procedure on inventory, but not relevant here because audit work was complete.

**Answer comment (part lii)**

“Amend the financial statements to show the net realisable value of oil at £15 / barrel.”.

**Examiners assessment of comment**

This was another common error in many answers. Auditors cannot amend the financial statements; only present an opinion on the financial statements provided to them by the directors.

Other common errors included:

- Considering resignation if the directors refuse to amend the inventory value; this was normally considered too extreme in this situation; a qualification of the audit report being sufficient,
- Provision of every possible type of audit report modification/qualification without clearly explaining first that the directors' amendments needed to be reviewed and then the appropriate report produced dependent on those amendments.

The overall standard of answer was inadequate. As in previous examinations, candidates need to consider carefully the time positioning of the question and not go back and repeat audit produces that should, by the end of the audit, already be complete.

**5b**

Candidates were expected to state and discuss various responsibilities, reporting options and safeguards regarding fraud affecting the external auditor.

The question was worth 12 marks over three sub-sections.

In part (i), candidates were required to state the responsibilities of the external auditor regarding fraud. Given revisions to ISA 240 this was a relatively topical question. Many candidates managed to state 3 or sometimes 4 responsibilities to obtain a clear pass standard.

Common weaknesses in this section included:

- Talking around the main issue. For example, many candidates explained the responsibilities of management, internal audit and even the audit committee without managing to bring external auditors into their answers.
- Providing comments that were not quite correct. For example, stating that external auditors were responsible to detect all fraud, or in some cases that they had no responsibility at all.
- Providing lengthy explanations of actual watch-dogs and blood-hounds rather than auditor responsibilities.

Overall, the question was fairly well answered.

In part (ii), candidates were required to discuss groups who could be informed regarding the fictitious inventory. 6 marks were available with up to 2 marks for each group discussed.

There were two key issues that limited the marks obtained from this question;

- Firstly, identifying the appropriate groups. The directors appear to have entrenched their view that the inventory is to be revalued; reporting back to the directors appears therefore to be inappropriate. Other reporting options are also limited by confidentiality issues; hence reporting to the bank or payables is probably not acceptable. However, there are still plenty of groups to report to including the audit committee, various authorities potentially including fraud reporting, etc. Many candidates obtained 3 or 4 marks by simply identifying the groups.
- Secondly, discussing why each group was being reported to. Almost all candidates found this discussion element of the question difficult. For example, candidates did mention that reporting to the audit committee was appropriate, but not that the committee as independent NEDs could hopefully persuade the board that simply making up a inventory figure was wrong and could provide grounds for the members to remove the directors (let alone mentioning the legal implications of the act).

Most candidates therefore obtained marks for identifying groups, but few marks were obtained for stating why those groups were being reported.

In part (iii), candidates were required to discuss the safeguards protecting the auditor from the intimidation threat of being removed from office for qualifying the audit report. Most candidates managed to mention key safeguards of resignation and qualifying the audit report anyway. However, other points such as discussion with the audit committee, discussion with the auditors professional body, etc were not always mentioned.

Common errors included:

- Suggesting safeguards that did not appear to be effective such as referring directors to the engagement letter.
- Stating that the auditor should convene a shareholders' meeting. This point was only valid when linked to resignation as otherwise the auditor could not ask for a meeting to be convened.
- Suggesting that the auditor should speak at the annual general meeting. This would not be immediately effective and would only be helpful when linked to resignation or removal.

Overall, the standard of answers could have been better given a little thought about the effectiveness of the safeguard being mentioned in the answers.