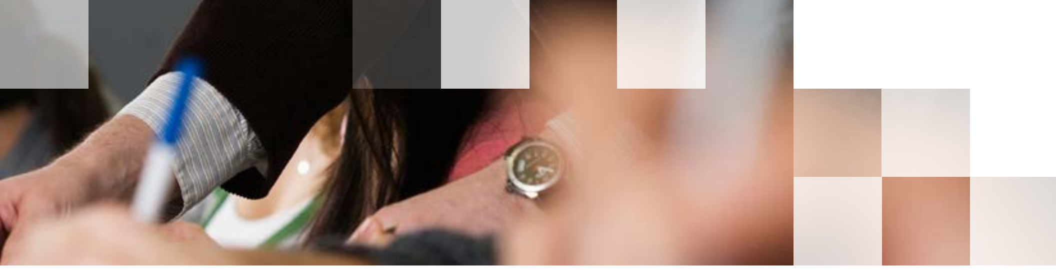
Embracing change. Shaping futures.

Audit and Assurance

Read the mind of an AA marker

Think Ahead

Contents



Introduction

I am a member of the team who will mark Audit and Assurance. This article is designed to give you, the candidate, an insight into my mind, so that you can better understand what a marker will be looking for when it comes to marking your Audit and Assurance script.

Insight into a marker's thinking – appreciating what we are trained to look for, what we award marks for, the reasons why marks may not be awarded – will help you fulfil your potential and gain the necessary marks to pass.

It will help you appreciate the points that will attract marks so that you can better assess your answers when practicing questions.

This article uses two sets of candidates' answers to requirements selected from the March 2018 and June 2018 exams.

To support your reading of this article, you should refer to the March/June 2018 – Sample Questions. **Click the link here**.

Fulfil your potential and gain the necessary marks to pass.

Question 17

Part (b) of Question 17 uses a very common style of requirement, namely to 'describe audit risks and explain the auditor's response to each risk'. Here the question called for EIGHT risks and responses. It is important to plan your time and give only the required number of risks, even though the scenario will always contain more than the specified number.

> **Audit risk is and will continue to be an important element of the syllabus.**

The examiner advises that future candidates must take note that audit risk is and will continue to be an important element of the syllabus and must be understood. Candidates must also ensure that they include adequate question practice as part of their revision of this key topic.

(b) Describe EIGHT audit risks and explain the auditor's response to each risk in planning the audit of Blackberry Co.

16 marks

Observations on the requirements

The 16 marks reflects the fact that each risk/response is worth 2 marks which will be awarded as follows:

For identification of each audit risk – ½ mark each

For explanation of each risk – ½ mark

For an appropriate auditor's response to each risk – 1 mark

To explain an audit risk it is necessary to state the relevant financial statement assertion that is affected (e.g. completeness/cut-off/valuation, etc) or whether amounts could be over/under/misstated or the effect on inherent/control/detection risk.

An auditor's response is an approach the audit team will take to address the identified risk; it does not have to be a detailed audit procedure. 'Discuss with management' is not sufficient to deal with any identified risk. You will have to apply your knowledge of audit procedures to provide a valid response which would adequately address the risk identified.

As you will see when you look at the marked answers in this article, it is not possible to achieve a pass mark to such questions by the mere statement of knowledge – it must be tailored to the specific scenario provided.

> **Knowledge must be tailored to the specific scenario provided.**

Notes on candidate one's answer to Q17 (b)

Follow this link to see candidate one's answer to Q17 (b)

View it here

Note 1
Credit for identifying that there is a risk associated with the inventory. However, the statement of IAS 2 knowledge is not relevant to the specific risk concerning inclusion of general overheads. How inventory should be valued is not an auditor's response (and the statement is incorrect). To recalculate inventory correctly is management's responsibility, not an auditor's response.

Note 2
No marks awarded as the number of warehouses is not the issue.

Note 3
Full mark awarded for identifying a risk and correctly stating its effect on the financial statements. However, the suggested response is not linked to the risk and the auditor would not need to rely on an expert.

Note 4
Credit for identifying that there is a risk associated with the issue of shares at a premium. However, the risk did not concern approval and hence review of board minutes is not a relevant response. Credit given for confirming the receipt of share proceeds.

Note 5
Credit for identifying that there is a risk associated with the fraud. However, the risk is not understatement of receivables. Full mark awarded for appropriate response with reason.

Note 6
This is a continuation of the risk identified in the previous point. Credit is given here for correctly identifying the risk as overstatement of receivables. No mark given for response as "100% test" is too vague and to adjust the financial statements is management's responsibility (as in Note 1). Note that even if an appropriate response had been given here, it would not be given further credit because the mark for the response to this risk has already been awarded (see Note 5).

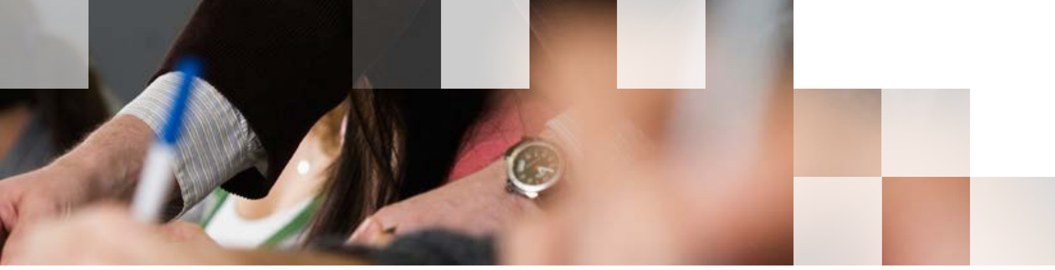
Note 7
Credit for identifying that there is a risk associated with outsourcing the sales ledger. However, as there is no explanation of this in terms of audit risk, the response does not address an assessed risk.

Note 8
Credit for identifying that there is a risk associated with the threat of litigation. However, the increased risk of losses is a business risk, not an audit risk. Full mark given for relevant enquiry of the company's lawyer. Note that application of knowledge of IAS 37 to explain the risk would have been given credit.

The mark for candidate one for Q17 (b) is 6½/16.

TOTAL:

6½/16



Notes on candidate two's answer to Q17 (b)

Follow this link to see candidate two's answer to Q17 (b).

View it here

Note 1
Full mark awarded for identifying the risk and stating its effect on the financial statements. However, an accounting treatment is not an auditor's response.

Note 2
Full mark awarded for identifying the risk and stating its effect on the financial statements. Full mark for a relevant auditor's response.

Note 3
Credit given for identifying that there is a risk associated with the cost of the payment. Although how it should be treated is correct, it does not explain the audit risk (i.e. that expense is overstated). The auditor's response is not appropriate because this is not how the patent has been treated in the financial statements.

Note 4
Credit for identifying that there is a risk associated with the fraud. However, how the wrong allocation affects the financial statements is not explained. Full mark awarded for appropriate response with reason.

Note 5
Credit for identifying that there is a risk associated with the threat of litigation. However, there is no explanation in terms of audit risk. Full mark given for relevant enquiry of the company's lawyer.

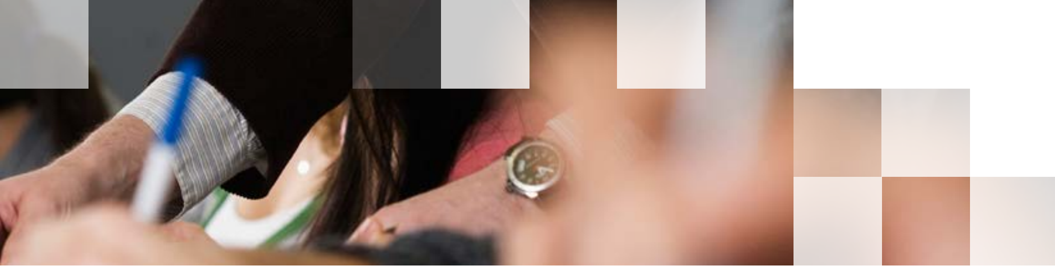
Note 6
Credit for identifying that there is a risk associated with the lack of reconciliations. However, the explanation concerns business risk, not audit risk. Credit given for relevant response. Further detail was needed for the full mark (e.g. 'and reconcile statements to ledger balances to ensure all transactions are recorded').

Note 7
Credit given for identifying that there is a risk associated with the current asset. Although how it should be treated is correct, it does not adequately explain the audit risk (i.e. that current assets are overstated). The first point of the response is sufficient to be awarded the full mark – it is a procedure and it has a purpose. The second point is also relevant and would be worth a mark but the mark has already been given for this risk. Again, an accounting treatment is not an auditor's response.

The mark for candidate two for Q17 (b) is 11/16**.**

TOTAL:

11/16



Question 18

Audit evidence is the area of the syllabus that requires a description of the work and evidence obtained by the auditor to meet the objectives of audit engagements and the application of International Standards on Auditing. A key requirement of this part of the syllabus is an ability to describe relevant audit procedures for a particular class of transactions or account balances. Generally, questions in this syllabus area will cover a variety of areas across both the statement of profit or loss and statement of financial position.

Care must be taken to address the specifics of the question; where the requirement is to describe substantive procedures to address specific financial statement assertions, such as valuation, any procedures that do not address this assertion would not score any marks.

If a requirement does not reference specific financial statement assertions, you must read the requirement even more carefully to ensure that you answer the question set. Parts (a)-(c) of Q18 are good illustrations of this.

(a) Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Gooseberry Co's research and development expenditure. **(5 marks)**

(b) Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to the matters identified regarding depreciation of property, plant and equipment. **(5 marks)**

(c) Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to the directors' bonuses. **(5 marks)**

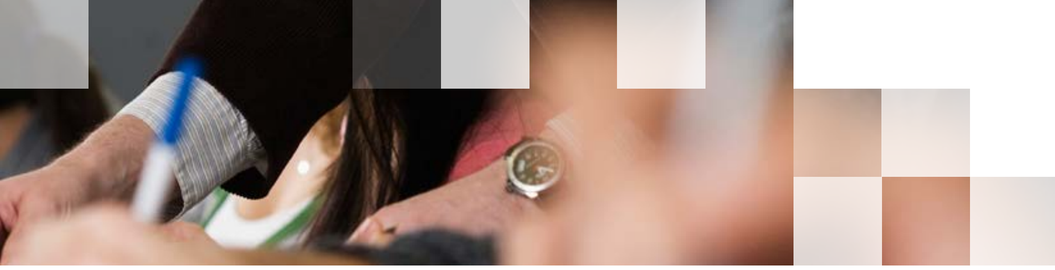
Observations on the requirements

One mark would be awarded for each well described substantive procedure. Hence, for each of these 5 mark requirements, you should aim to provide at least five substantive procedures.

Details in the scenario were clearly headed 'Research and development', 'Depreciation' and 'Bonus'. Careful reading of the scenario is always essential before writing an answer. Part (a) prompts this with 'in relation to *Gooseberry Co's* research and development expenditure' and (b) with 'in relation to the *matters identified* regarding depreciation …'

Procedures which are not relevant to the requirement or the scenario will earn no marks. Candidates must be prepared to tailor their knowledge of substantive procedures to any area of the financial statements.

Candidates must be prepared to tailor their knowledge of substantive procedures.



Notes on candidate one's answer to Q18 (a)-(c)

Follow this link to see candidate one's answer to Q18 (a)-(c).

View it here

Note 1
This point is not relevant. Although the calculation of materiality is correct, it does not answer the question.

Note 2
No mark given as 'Discuss' alone is inadequate as a substantive procedure.

Note 3
This 'rote-learnt' point has no relevance to the given scenario. Even though the requirement has been written out, the candidate has not yet properly read it. As a point of exam technique, it is better to reduce the requirement to a concise heading on which to focus.

Note 4
Mark given for stating how the evidence is obtained and what is achieved by the procedure.

Note 5
No mark given as there is no indication how the criteria could be applied. Also, the main concern related in the scenario is that costs are incorrectly capitalised and not that they are incorrectly expensed.

Note 6
Credit given for recognising a benchmark in the industry. For a full mark it was necessary to suggest *how* this could be confirmed (e.g. comparing with accounting policy notes in the financial statements of relevant companies).

Note 7
Credit given for a relevant disclosure to be agreed in the financial statements.

Note 8
As for Note 3

Note 9
No marks as these rote-learnt points are not relevant to 'the matters identified regarding depreciation'.

Note 10
Credit given for recognising the need to verify the basis. However, it does not go far enough in describing *how* this would be verified.

Note 11
Mark given for a clear substantive procedure and purpose that is relevant to the scenario.

Note 12
Credit given but point is not sufficiently explicit on where the disclosures are or what they should be reviewed against.

Note 13
As for Note 11.

Note 14
Credit given for a relevant procedure, but for full mark needed to be more specific about the bonus amount(s) that could be agreed.

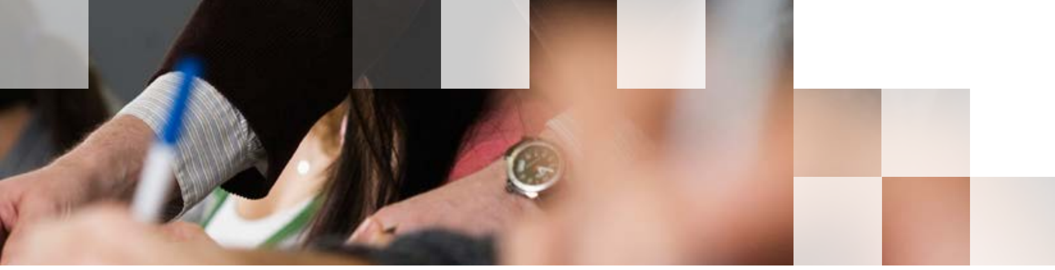
Note 15
No mark given as any confirmation of payment would be found in the cash book/bank statement.

Note 16
Credit given for a relevant procedure but for a full mark this had to be tailored to the specifics of the scenario (i.e. reviewed against the requirements of local legislation).

The mark for candidate one for Q18 (a)-(c) is 6/15.

TOTAL:

6/15



Notes on candidate two's answer to Q18 (a)-(c)

Follow this link to see candidate two's answer to Q18 (a)-(c).

View it here

Note 1
Credit given but for full mark needed to recognise that the intangible asset was the main issue rather than an expense.

Note 2
Similar to Note 1, there was more than a total expense to be agreed to the general ledger.

Note 3
Each of these points applies a criterion of IAS 38 in a practical way and is therefore worth a full mark.

Note 4
Credit given but point lacks sufficient detail for full mark.

Note 5
This 'rote-learnt' point is irrelevant to the given scenario.

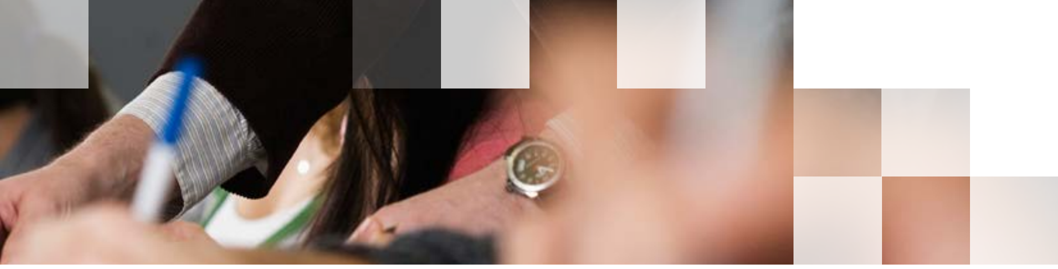
Note 6
Each of these points sufficiently describes a substantive procedure that is specific to the scenario and therefore worth a full mark.

Note 7
Credit given for relevant matter to be discussed with the finance director, but further consideration needed for full mark.

The mark for candidate two for Q18 (a)-(c) is 10/15**.**

TOTAL:

10/15



Think Ahead ACCA

March/June 2018 exam marked answers

Question 17 (b) candidate one

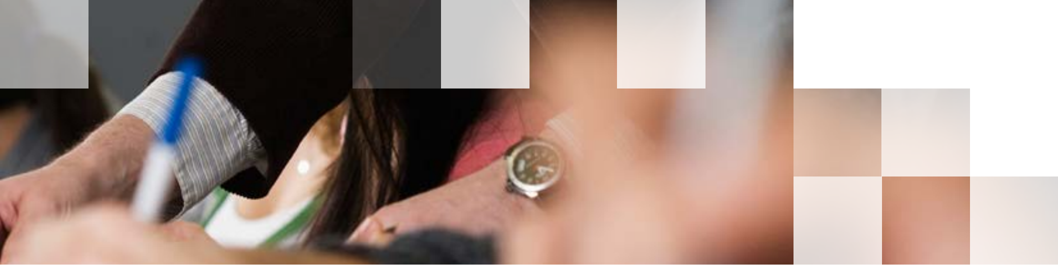
Marks

✓ denotes ½ a mark

Notes

Audit Risk	Auditor's Response	Marks	Notes
1. Inventory cost is made up of the purchase price of raw materials and costs of conversion including labour, production and general overheads. ✓ Under IAS 2, inventory should be measured at the lower of cost and net realisable value.	Inventory cost should only include the cost of raw materials. The auditor should obtain a breakdown and recalculate inventory in compliance with IAS 2.	½	← Note 1
2. Inventory is held in three warehouses located across the country. It is impossible for the auditor to attend all the inventory counts. In addition, the cost of travel is not worth the benefits.	Auditor should attend inventory counts in warehouse that has a history of having its inventory misstated or the warehouse with the most material amount of inventory.	0	← Note 2
3. The purchase of the patent, the $1.1m has been expensed in the current year statement of profit or loss. The classification was not properly done. The expense was overstatement and the patent (intangible asset) was understated. ✓✓	Auditor should assess whether the criteria of IAS 38 Intangible Assets have been met. Auditor may need to rely on an expert.	1	← Note 3
4. Blackberry raised $1.2m through issuing shares at a premium. ✓ Is the share issue properly approved by the board of Blackberry?	Auditor should review the board minutes to ensure the authorisation to issue shares is properly approved. And also trace to the bank statement to ensure the receipt of $1.2m. ✓	1	← Note 4
5. A significant teeming and lading fraud was discovered. ✓ There is a risk that some fraud hasn't been detected and receivables may be understated.	Auditor should discuss with management how the fraud occurred and also inquire into proposed actions to be taken to prevent similar occurrence in the future. ✓✓	1½	← Note 5
6. The funds were stolen by four members of the sales ledger department as they allocated later customer receipts against the older receivables. This is a risk that the receivables may be overvalued. ✓	As a fraud occurred relating to receivables the auditor has to 100% test receivables. The auditor has to make an adjustment to the financial statements if necessary to ensure the appropriate receivables amount as at year ended 31 March 20X8.	½	← Note 6

Relevant notes



Marks

✓ denotes ½ a mark

Audit Risk	Auditor's Response
7. Blackberry decided to outsource its sales ledger department to an external service. ✓ The reliance on the external service has to be questioned as this can damage the reputation of Blackberry.	Discuss with the finance director the technical expertise of the external company. The auditor should also review the agreement between both companies.
8. The financial accountant of Blackberry threatened to sue the company for unfair dismissal. ✓ There is an increased risk of losses as compensation may be significant.	Auditor should make an enquiry to Blackberry's lawyer about the status and possible outcome of the case. ✓✓ If Blackberry is likely to lose the case, then a provision should be made under IAS 37.

½

1½

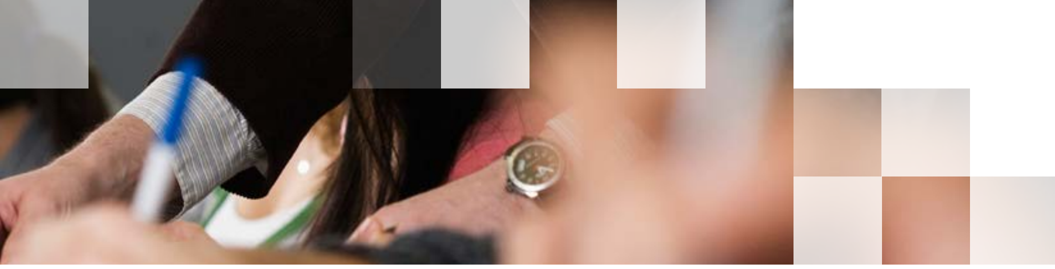
TOTAL – Part (b):
6½/16

Notes

← *Note 7*

← *Note 8*

Relevant notes



Marks

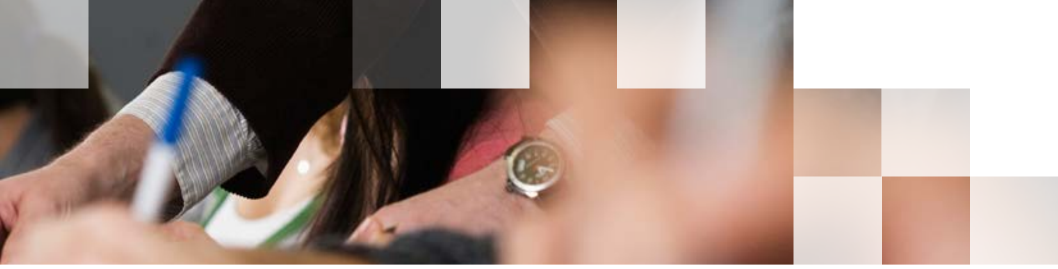
Question 17 (b) candidate two

✓ denotes ½ a mark

Notes

Audit Risk	Auditor's Response	Marks	Notes
1) General overheads are included in the valuation of inventory. This leads to overstatement of closing inventory. ✓✓	IAS 2 Inventory states that cost of inventory includes materials, direct labour and production overheads.	1	Note 1
2) Full inventory count will be held on 2, 3, 4 April, any necessary adjustments will be made to reflect post year-end movements. Inventory could be over or understated due to cut-off errors. ✓✓	Increase cut-off testing using goods received notes and goods despatch notes from 31 March to 5 April. ✓✓	2	Note 2
3) The cost of purchasing the patent has been expensed. ✓ It should have been capitalised in accordance with IAS 38 Intangible Assets and amortised.	As it is probable that the useful life is three years, review the financial statements to ensure it reflects this.	½	Note 3
4) The teeming and lading fraud means that customer receipts have been wrongly allocated to older receivables. ✓	Request external confirmation of receivables balances and investigate all discrepancies which may include stolen cash. ✓✓	1½	Note 4
5) Blackberry ran its sales department until 31 January 20X8 at which point the records were transferred to the service organisation. There is a risk that records transferred were not complete and accurate, therefore receivables may be understated or overstated. ✓✓	Compare closing balance in Blackberry's sales ledger as at 31 January with the service organisation's opening balance. ✓✓	2	Note 2
6) The financial accountant was dismissed and is threatening to sue the company for unfair dismissal. ✓ There might be a present obligation arising from the lawsuit.	Discuss with legal advisors of the company to confirm the probability he wins the case. ✓✓	1½	Note 5

Relevant notes



Marks

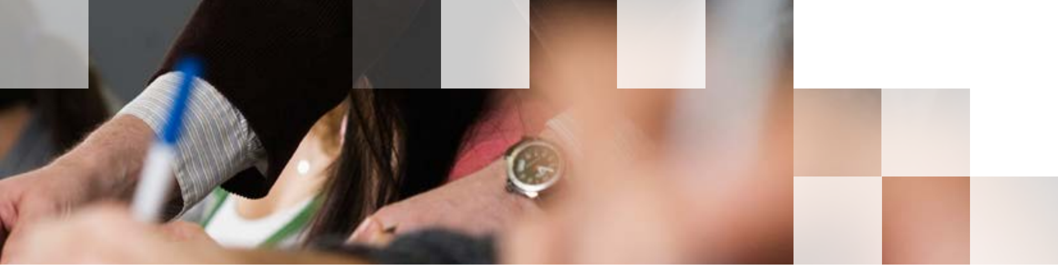
✓ denotes ½ a mark

Notes

Audit Risk	Auditor's Response	Marks	Notes
7) The new accountant will start in April and no supplier reconciliations or purchase ledger control account reconciliations were performed during the period. ✓ Differences between the company's and suppliers' balances could result in delayed payments and loss of supplier goodwill if credit limits are not respected.	Obtain permission from Blackberry to send a payables circularisation. ✓	1	← *Note 6*
8) Blackberry has included a current asset of $360,000 following the statement made by the liquidators of the bankrupt customer. ✓ As it is only likely, only a disclosure should be included in the financial statements.	Inspect cash book for after year end deposits. If received the treatment is correct. ✓✓ If not received, review the correspondence between Blackberry and the liquidator. Assess whether the amount is likely to be received. IAS 37 states that only highly probable inflows can be recorded as an asset before it is received.	1½	← *Note 7*

TOTAL – Part (b):
11/16

Relevant notes



Question 18 (a)-(c) candidate one

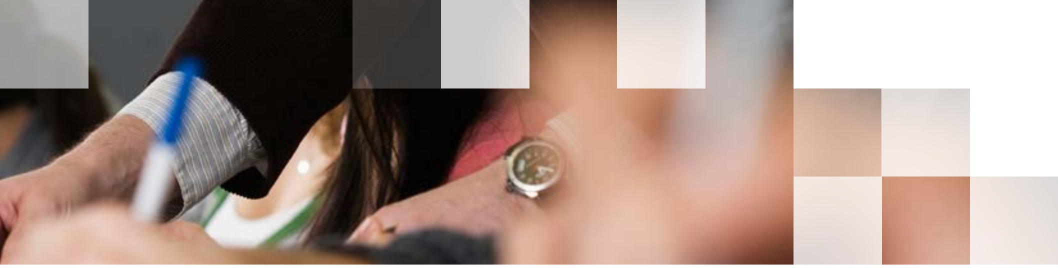
Part (a)

a) Substantive procedures to perform to obtain sufficient and appropriate audit evidence in relation to Gooseberry's research and development expenditure.

	Marks	Notes
1. 1.6/6.4 = 30% which is material so some additional substantive procedure are needed.	0	← Note 1
2. Discuss with management how the development cost has been valued.	0	← Note 2
3. Compare the opening figure of research and development with the year end research and development figure of the period year and investigate any variances.	0	← Note 3
4. Obtain evidence that the $1.9m has been actually spent by checking for invoices of payments and casting the figures to ensure it adds up to $1.9m.	1	← Note 4
5. Verify that there are not other costs incurred in the research and development that have been wrongly expensed by getting a comprehensive list of all expenses incurred to date in research and development and applying IAS 38 criteria.	0	← Note 5
6. Confirm that 3 years useful life of the intangible asset corresponds with industry standard.	½	← Note 6
7. Verify that the relating amortization expense has been written off the statement of profit or loss.	½	← Note 7

TOTAL – Part (a): 2/5

Relevant notes



Part (b)

	Marks	Notes
b) Substantive procedures to perform to obtain sufficient and appropriate audit evidence in relation to depreciation of property, plant and equipment (PPE)	0	Note 8
1. Obtain a schedule of all the opening balances of all the PPE and compare with the closing balances of the period year. Investigate any variances.	0	Note 9
2. Test the existence of a sample of the PPE by requesting the documents of ownership and rights to use.		
3. Recast the closing values of the portfolio of PPE to ensure there was no error in calculation.	0	Note 9
4. Verify the basis of the update if the useful lives, residual values and depreciation rates/methods used this current year and ensure they are in alignment with industry standard.	½	Note 10
5. Recalculate the depreciation charge for each category of asset based on updated useful lives, residual values and depreciation rates/methods to ensure no arithmetic inaccuracy exists.	1	Note 11
6. Review the various disclosures made in the light of the changes made to the useful lives, residual values and depreciation rates/methods.	½	Note 12

TOTAL – Part (b): 2/5

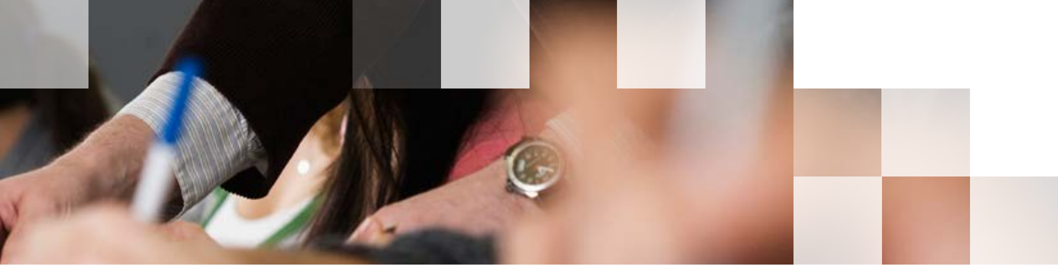
Part (c)

	Marks	Notes
c) Substantive procedures to perform to obtain sufficient and appropriate audit evidence in relation to directors' bonuses		
1. Recalculate the bonus based on the draft year-end net assets, excluding intangible assets.	1	Note 13
2. Agree the amount of bonus back to the payroll records.	½	Note 14
3. Inspect the directors' service contract to confirm that any additional bonus to which the directors are not entitled has not been paid.	0	Note 15
4. Review the financial statements for disclosure of director's bonus.	½	Note 16

TOTAL – Part (c): 2/5

TOTAL – Q18 (a)-(c): 6/15

Relevant notes



Question 18 (a)-(c) candidate two

a) Substantive procedures for research and development

Procedure	Marks	Notes
• Obtain list of research and development expenditure and cast to ensure accuracy.	½	Note 1
• Agree total to the general ledger to ensure completeness.	½	Note 2
• Review cash flow forecast to confirm that sufficient finance is available to complete the developments.	1	Note 3
• Inspect board minutes for discussions about issues in the development stage and sales launch of health and beauty products.	1	Note 3
• Recalculate amortisation on development cost and compare with previous year.	½	Note 4

TOTAL – Part (a): 3½/5

b) Substantive procedures for PPE

Procedure	Marks	Notes
• Calculate the depreciation charge, compare it with prior years and investigate significant difference.	0	Note 5
• Calculate depreciation charge for a sample of assets and check whether correctly recorded in the non-current asset register.	1	Note 6
• Discuss with the finance director about the rationale for updated useful lives, residual values and depreciation rates.	½	Note 7
• For a sample of assets sold, check the profit or loss on disposal to assess the validity of changing depreciation rates.	1	Note 6
• Review the financial statements for proper disclosure under IAS 16 Property, plant and equipment relating to changes in depreciation.	1	Note 6

TOTAL – Part (b): 3½/5

Relevant notes

Marks

Notes

c) Substantive procedures for directors' bonuses

• Obtain and review directors' contracts to verify bonus entitlement and payment terms.	1	Note 6
• Calculate the total bonus payment, compare this to prior year to identify any significant differences and discuss with management regarding the matter.	0	Note 5
• Review post year cash book and bank statement to agree the amount of bonus paid.	1	Note 6
• Review financial statements to verify separate disclosure of bonus according to local legislation.	1	Note 6

TOTAL – Part (c):
3/5

TOTAL – Q18 (a)-(c):
10/15

Relevant notes

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