ACCA Think Ahead

Audit and Assurance (AA) Sept/Dec 2021 Examiner's report



The examining team share their observations from the marking process to highlight strengths and weaknesses in candidates' performance, and to offer constructive advice for those sitting the exam in the future.

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General comments

This examiner's report should be used in conjunction with the published March/June 2021 sample exam which can be found on the ACCA Practice Platform.

The Audit and Assurance exam is offered in computer-based (CBE) format. The model of delivery for the CBE means that candidates do not always receive the same set of questions. In this report, the examining team share their observations from the marking process to highlight strengths and weaknesses in candidates' performance, and to offer constructive advice for future candidates.

- Section A objective test (OT) case questions – here we look at the key challenge areas for this section in the exam.
- Section B constructed response (CR) questions – guidance on how to complete all published CR questions from the sample exam.

There are two sections to the examination and all the questions are compulsory. Section A consists of three OT cases each comprising five OT questions for a total of 30 marks, which cover a broad range of syllabus topics. In Section B candidates are presented with one CR question worth 30 marks and two CR questions worth 20 marks each, testing the candidates' understanding and application of audit and assurance in more depth.

In order to pass this examination, candidates should ensure they devote adequate time to obtain the required level of knowledge and application.

Section A

Candidates preparing for future sessions are advised to work through the past exams which are available and to carefully review how each of the correct answers were derived. Section A questions aim to provide a broad coverage of the syllabus, and future candidates should aim to revise all areas of the AA syllabus, rather than attempting to question spot.

Sample questions for discussion

The following questions are reviewed with the aim of giving future candidates an indication of the types of questions asked, guidance on dealing with exam questions and to provide a technical debrief on the topics covered by the specific questions selected. Candidates are reminded that there will be a mix of application and knowledge questions in Section A and it is imperative that they ensure their knowledge of the International Standards on Auditing (ISAs), relevant financial accounting and important areas of the syllabus such as auditors' reports is at an appropriate level. Questions may test specific details of examinable documents including ISAs, ACCA's Code of Ethics and Conduct and the UK Corporate Governance Code, therefore candidates must ensure that they have studied these in sufficient depth. Candidates must also ensure that they have studied all areas of the syllabus. The syllabus includes audit evidence learning outcomes relating to a wide range of specific items, any of which may be examined.

Example of a case scenario

It is 1 July 20X5. You are an audit supervisor of Willow & Co and you are involved in the audit of Ash Co for the year ended 31 May 20X5. You have been allocated responsibility for the audit of bank and cash and share capital.

Bank and cash

Ash Co has various accounts with two banking institutions. It holds a number of longstanding accounts with Silver Oak bank and a number of new accounts have been opened during the year with Moneytree bank. However, the management of Ash Co has refused to grant Willow & Co permission to obtain a bank confirmation letter from Moneytree bank. You have asked for an explanation but have not received a satisfactory response.

The area of bank and cash has been deemed as high risk due to a number of errors which were found during the prior year audit. The audit engagement partner has therefore emphasised the importance of the procedures performed in this area of the financial statements.

Share capital

During the year to 31 May 20X5, Ash Co issued 100,000 $1 equity shares. Ash Co maintains all of its own records in this area. The audit engagement partner has raised concerns over whether the transaction has been carried out in compliance with appropriate laws and regulations.

Question 1

You are reviewing the audit plan for Ash Co and have allocated a number of procedures to be performed on bank and cash to your audit assistant. In order to help your audit assistant perform the work you want to give them more detail regarding the procedures.

Which type of audit procedure is being demonstrated by each of the following tests included in the audit plan of Ash Co?

Obtain Ash Co's bank reconciliation and cast to ensure mathematical accuracy	**REPERFORMANCE**	**INSPECTION**	**RECALCULATION**	**EXTERNAL CONFIRMATION**
Obtain a bank confirmation letter from Ash Co's bankers	**REPERFORMANCE**	**INSPECTION**	**RECALCULATION**	**EXTERNAL CONFIRMATION**
Perform a cash count for comparison with the results of the cash count conducted by Ash Co	**REPERFORMANCE**	**INSPECTION**	**RECALCULATION**	**EXTERNAL CONFIRMATION**

The correct answers are: Test 1 = recalculation, Test 2 = External confirmation, Test 3 = Reperformance.

This question examines candidates' understanding of the different types of audit procedures which the auditor may use to obtain audit evidence and also the ability to apply this understanding to specific examples of procedures performed. Casting the bank reconciliation to ensure it is mathematically accurate is an example of a recalculation procedure. Obtaining the bank confirmation letter is an example of an external confirmation as the bank is a third-party source. Performing the cash count and comparing the results with the cash count already carried out by the company is an example of a reperformance procedure.

Question 2

Your audit assistant has gathered the following audit evidence in relation to bank and cash:

(1) Print out from Ash Co's online banking system provided by the accounts clerk
(2) Bank reconciliation prepared by the audit assistant using client documents
(3) Results of cash count performed by internal audit
(4) Bank confirmation letter received from Silver Oak bank

In order to respond to the increased level of risk you want to make sure you are using the most reliable evidence.

Which of the following options correctly ranks the audit evidence, starting with the MOST reliable?

A. 2, 4, 1, 3
B. 2, 3, 4, 1
C. 4, 3, 1, 2
D. 4, 2, 3, 1

The correct answer is: D

ISA 500 Audit Evidence states that the reliability of information used as audit evidence is influenced by its source and its nature and the circumstances under which it is obtained. It also states that while exceptions may exist, the following generalisations can be made:

- The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- The reliability of evidence generated internally is increased when related controls are effective.
- Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.
- Audit evidence in documentary form is more reliable than evidence obtained orally.

In the case of the evidence collected in respect of Ash Co, the bank confirmation letter received from Ash Co’s bank described in (4) is the most reliable. It is evidence from an independent party outside the entity and as it is the bank it would be a knowledgeable source. Auditor generated evidence is normally seen as a reliable source, however in this case as described in (2) its reliability is affected by the fact

that the reconciliation is prepared using client documents. Audit evidence (1) and (3) are both sources of evidence generated by the client. However due to the nature of their role internal audit would be viewed as being more independent than an accounts clerk, therefore (3) would be more reliable than (1).

Question 3

Which TWO of the following actions should Willow & Co take following Ash Co's refusal to allow Willow & Co to seek a bank confirmation from Moneytree bank?

A. The risk of material misstatement including fraud risk needs to be re-evaluated
B. The audit plan must be revised and alternative procedures considered
C. A modified opinion must be issued on the grounds that insufficient evidence is available
D. Send the bank confirmation request without authorisation as the bank communicates directly with the auditor

The correct answers are: A & B

This question emphasises the importance of candidates being able to think practically. In this case Ash Co has restricted Willow & Co's ability to collect audit evidence. As a result it would be appropriate to re-evaluate risk. It would also be appropriate to revise the audit plan accordingly in the light of this and to determine whether sufficient appropriate evidence can be obtained by alternative means.

Option C is incorrect as although a modified opinion may ultimately be the end result further procedures may be possible therefore it would not be appropriate to conclude that a modified opinion **must** be issued at this stage. Option D is incorrect as the bank would not respond to the request without permission from Ash Co.

Question 4

You have been given the following bank reconciliation prepared by Ash Co:

MONEYTREE BANK - CURRENT A/C	
	$'000
Balance per bank statement at 31 May 20X5	4,200
Adjusted for:	
Unpresented cheques	(1,200)
Outstanding lodgements	3,200
Balance per cashbook at 31 May 20X5	**6,200**

The following issues have been identified during the testing of the bank reconciliation:

(1) Cheques totalling $300,000 which were not posted until 2 June 20X5 are included in the cash book at the year end
(2) Customer payments totalling $700,000 which were paid into the bank on 3 June 20X5 are included in the cash book at the year end
(3) Bank charges for May 20X5 totalling $100,000 were not charged by the bank until June 20X5

What is the resultant effect on the bank and cash balance as a result of these issues?

A. Bank and cash is overstated by $400,000
B. Bank and cash is understated by $300,000
C. Bank and cash is overstated by $500,000
D. Bank and cash is understated by $400,000

The correct answer is: A

In order to carry out an effective audit the auditor must have a good understanding of financial accounting. This question examines the impact on the bank and cash balance of issues identified as part of the audit of the bank reconciliation. A key point to remember is that it is the cash book figure (adjusted if required) which will appear in the financial statements.

In this case two issues have been identified in the preparation of the cash book. The total has been incorrectly reduced by $300,000 in respect of cheques which were not posted until after the year end and has been incorrectly increased by $700,000 in respect of lodgements not submitted until after the year end. The net effect of this is an overstatement of $400,000. As the bank charges were not charged by the bank until June these would have been recognised as an accrual at the year end and therefore would have no effect on the year-end bank and cash balance.

Question 5

Which of the following procedures would address the audit engagement partner's concern in relation to the share issue?

A. Inspect board minutes for evidence of review regarding the terms of and approval of the share issue
B. Inspect Ash Co's constitution documents for evidence that the share issue is permitted
C. Obtain a written representation from management to confirm that the share issue is in compliance with laws and regulations
D. Agree the quantity and recipients of the share issue to Ash Co's share register

The correct answer is: B

The AA syllabus includes learning outcomes which cover a wide range of balances in both the statement of profit or loss and the statement of financial position. This question examines procedures relating to a share issue. Candidates should be prepared for questions on any of the balances listed in the syllabus.

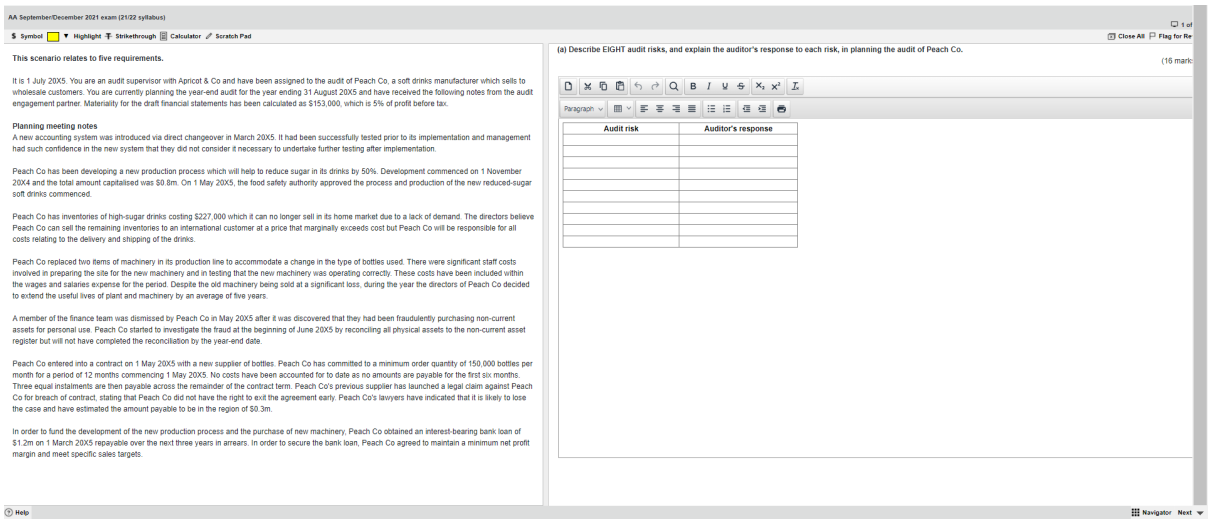
This question also highlights the importance of careful reading of the requirement. Here candidates are required to consider which procedure will address the partner's concern ie over whether the transaction has been carried out in compliance with appropriate laws and regulations. Option B would be the appropriate response as it is the only procedure which would address this concern.

With this question candidates may find it useful to derive the correct answer through a process of elimination. Option A would show approval by the board but would not confirm whether the issue was lawful. Option C would not be appropriate as other evidence should be available. Option D would provide evidence regarding the recording of the share issue but does not provide evidence that the transaction

complies with laws and regulations. Option B is therefore the correct answer as explained above.

Section B

Peach Co



This 30-mark question is based on Peach Co, a soft drinks manufacturer which sells to wholesale customers. This question tests candidates' knowledge of audit risks and responses, responsibilities in relation to fraud and error, ethical threats and safeguards and substantive procedures for development expenditure.

Requirement (a) – 16 marks

Describe EIGHT audit risks and explain the auditor's response to each risk in planning the audit of Peach Co.

Marks are awarded for identification of audit risks (½ mark each), explanation of audit risks (½ mark each) and an appropriate auditor's response to each risk (1 mark each). With a scenario-based requirement such as this good exam technique is critical. The scenario will typically contain more than the number of risks required, so it is important that candidates plan their time carefully and only attempt to list the required number of points.

The first step is to identify the factors which will give rise to an audit risk. This information can be found in the scenario. All of the information in the scenario should be read carefully, including the opening paragraph as this may include information relevant to the identification of audit risks, such as whether this is a new client, which is often overlooked. When undertaking this read through, a useful technique which could be adopted would be to use the highlight function as this provides a visual aid for quickly spotting audit risks. Having looked at the whole scenario and highlighted relevant points, candidates should pick the points they are best able to develop, re-read them from the scenario, drafting their answer as they work through the issues taking care to address the number of risks stated in the requirement. In Peach Co the question requires eight risks to be identified and explained. Candidates should expect a range of topic areas within an audit risk scenario, some of which may be more challenging than others. In Peach Co for example many candidates failed to fully understand the risk relating to the costs omitted for the contract with the new bottle supplier.

Financial accounting knowledge is also important as audit risks will often focus on the accounting treatment used in the financial statements. In Peach Co accounting issues, which give rise to audit risks include those relating to intangible assets, property plant and equipment, inventory valuation and a legal provision.

Having identified the risk factor the next step is to explain the risk. To do this, candidates need to state the specific area of the financial statements impacted with an assertion (for example cut off, valuation etc.), or a reference to over/under/misstated, or a reference to inherent/control/ detection risk. 'Misstated' will only be awarded if it is clear the balance could be either over or understated. For example, if the risk should have been described in terms of an understated balance, then no credit would be awarded if candidates referred to a misstated balance. Candidates cannot hedge their bets by providing both options.

The explanation of the risk must also clearly state the specific area of the financial statements impacted. For example, in respect of the issue relating to development expenditure capitalised as part of intangible assets, only noting 'assets could be overstated' would not be awarded credit. An appropriate explanation in this instance would be 'intangible assets could be overstated'.

Care must also be taken to explain the risk based on the information within the scenario. For example, some candidates explained the issue of loan covenants relating to minimum profit and sales targets as being a going concern risk. However, there were no indications from the information provided that Peach Co was experiencing going concern difficulties or that this would be the consequence of any breach. In this case, the risk related to overstatement of profit and/or sales revenue in order to meet the covenants. Candidates must take the time to carefully read the scenario, noting any relevant information, to ensure that they correctly understand and describe the audit risks arising.

Having identified and explained the risk, the next step is to provide the auditor's response. Responses must be practical within the context of the scenario and care should be taken to ensure the response is an auditor's response and not a management response. Auditor responses do not have to be a detailed procedure, rather it is an approach the audit team will take. Care must be taken however to ensure that the approach suggested actually addresses the risk identified and contains sufficient detail. A response of 'discuss with management' will not gain any credit as candidates need to be very clear exactly 'what' they are 'asking management' about. For the new bank loan risk, an appropriate response would be 'carry out a review of the loan agreement to confirm the details and reperform the company's calculations to confirm that the loan has been correctly classified between current and non-current liabilities'. This clearly addresses the issue identified.

Where further documentary evidence is available to the auditor, candidates need to ensure that they refer to this. Also, consideration should be given to the reliability of audit evidence gained; for example, evidence gained via confirmation from a third party will be more reliable than verbal assertions from management. In Peach Co, the scenario specifically refers to information based on an assessment by their legal advisers. Therefore, an appropriate response would have been to 'review correspondence from Peach Co's lawyer to understand the likelihood of the claim being successful and likely sum to be paid.' This response would be more relevant and reliable than a discussion with management as to the likely outcome.

Future candidates are advised that audit risk is and will continue to be an important element in the syllabus and must be understood. Candidates must ensure that they include adequate question practice as part of their revision on this key topic.

Corley Appliances Co from the 'Sample March/June 2021 Questions', Hart Co from the 'Sample September/December 2020 Questions', Scarlet Co from the 'Sample March/July 2020 Questions', Harlem Co from the 'Sample September/December 2019 Questions' and Peony Co from the 'Sample March/June 2019 Questions' are good scenario-based questions on audit risks and responses to practice.

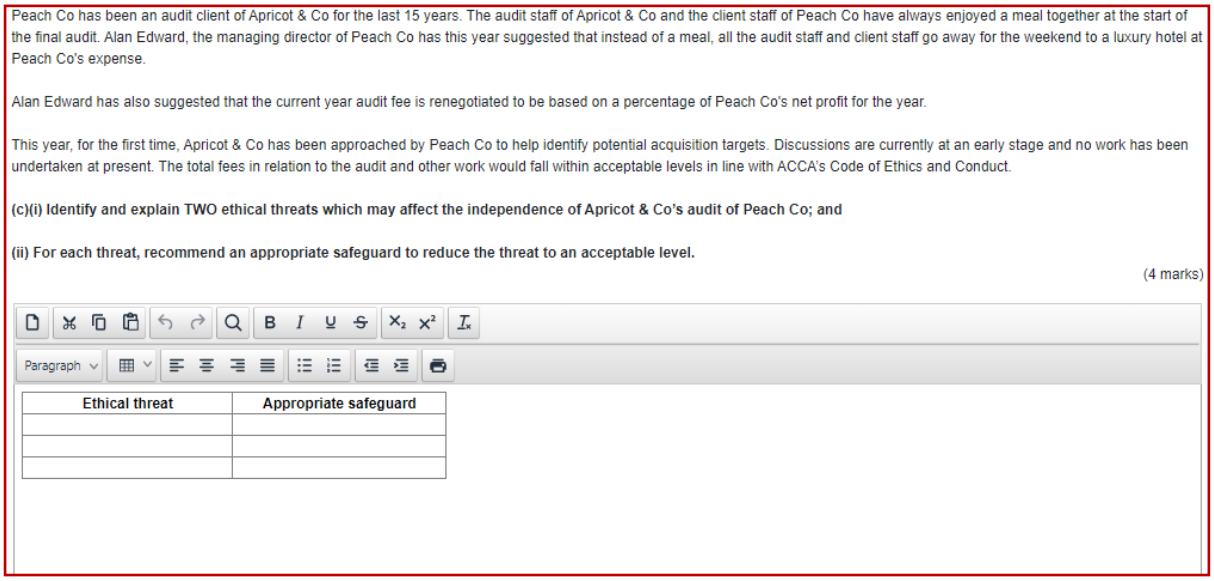
Requirement (b) – 4 marks

Describe Apricot & Co's responsibilities in relation to the prevention and detection of fraud and error.

Knowledge requirements such as this often have an opening statement, sometimes referenced to an ISA, and this is useful for setting the scene and providing clarification on the aim of the question requirement. It is particularly important that candidates understand exactly what the question is asking, especially for knowledge questions, where candidates should be aiming to score full marks.

Question requirements such as this demonstrate the importance of having a detailed understanding of the ISAs, and in this case ISA 240 The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements. For a four-mark knowledge requirement such as this, candidates should aim to provide four well-described points. Care should be taken when reading the requirement to ensure that answer points focus on the right issues. For example, in this session some candidates incorrectly focused their answers on management's responsibilities. This is despite the requirement only relating to the responsibilities of auditors. Candidates must take the time to carefully read and underline key words in the requirement to ensure their answer is relevant.

Requirement (c) – 4 marks


Peach Co has been an audit client of Apricot & Co for the last 15 years. The audit staff of Apricot & Co and the client staff of Peach Co have always enjoyed a meal together at the start of the final audit. Alan Edward, the managing director of Peach Co has this year suggested that instead of a meal, all the audit staff and client staff go away for the weekend to a luxury hotel at Peach Co's expense.

Alan Edward has also suggested that the current year audit fee is renegotiated to be based on a percentage of Peach Co's net profit for the year.

This year, for the first time, Apricot & Co has been approached by Peach Co to help identify potential acquisition targets. Discussions are currently at an early stage and no work has been undertaken at present. The total fees in relation to the audit and other work would fall within acceptable levels in line with ACCA's Code of Ethics and Conduct.

(c)(i) Identify and explain TWO ethical threats which may affect the independence of Apricot & Co's audit of Peach Co; and

(ii) For each threat, recommend an appropriate safeguard to reduce the threat to an acceptable level.

(4 marks)

Paragraph

Ethical threat	Appropriate safeguard

Identify and explain TWO ethical threats which may affect the independence of Apricot & Co's audit of Peach Co; and for each threat, recommend an appropriate safeguard to reduce the threat to an acceptable level.

For questions which examine ethical threats and safeguards, candidates are generally asked to identify and explain a specified number of ethical threats from a given scenario and give a relevant safeguard to address the threats identified. Candidates are awarded ½ mark for identifying the ethical threat and ½ mark for explaining the implication of the threat. Candidates are awarded 1 mark for each well explained safeguard.

In order to be awarded ½ mark for identifying the threat candidates are required to identify the issue from the scenario and correctly state which type of ethical threat it relates to, for example self-review threat. Both aspects of this response are required. For example, in Peach Co candidates needed to identify that the audit team had been invited to a luxury hotel at Peach Co's expense and also to state that this gives rise to a self-interest or familiarity threat.

The next step is to explain the implication of the threat clearly. Candidates often fail to do this and miss out on the ½ mark available. The explanation needs to clearly explain why this is an ethical issue. For example, just stating that 'this will impact on the auditor's independence' would not be awarded credit. Candidates must explain HOW independence will be impacted, for example 'accepting goods/service which have significant value may result in the audit team feeling unable to challenge management's explanations.'

The final step is to then suggest a safeguard and it is important that this is phrased as an action; often candidates provide objectives rather than actions. For example, for the threat relating to audit fees being based on the level of Peach Co's net profit, an appropriate response in order to gain the 1 mark available would be, 'the audit firm should inform Peach Co that they cannot agree to the proposed fee basis', or 'Apricot & Co should inform management that the audit fee will be based on the level of work undertaken.'

Additionally, safeguards must be practical. Constantly recommending that 'the audit firm should resign' is unlikely to be a sensible safeguard. While resignation would remove the ethical threat, it would also result in the loss of the audit. Resignation should be viewed as the last resort when considering safeguards. Alternative options where available should be considered first.

Requirement (d) – 6 marks

Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Peach Co's development expenditure.

For substantive procedures requirements, one mark is available for each well-described procedure, therefore candidates should aim to produce six tests for this requirement. Candidates should plan their time accordingly. Also, candidates should note that it is not necessary to reproduce the question requirement at the beginning of their answer, it does not gain any credit and is a waste of time.

When describing substantive procedures one of the key things to consider is the level of detail provided. Many candidates fail to score well in this type of requirement because their procedures are vague or too brief. Tests must be sufficiently detailed noting clearly which source document should be used and what for. For example, in this session some candidates included 'review market research reports' without specifying why this was being done or for what purpose, and so would have only gained ½ mark. In order to gain the 1 mark available this test would need to be expanded to include 'to confirm the directors view that a market exists for this project'.

Candidates must ensure that they can distinguish between a substantive procedure and a test of control. Many candidates lose marks in this type of requirement by mixing up these procedures. For example, in this session some candidates provided test of controls such as 'ensure that the expenditure is authorised by the board of directors.' The purpose of this procedure is to ensure that the controls over the expenditure are operating effectively, therefore this is not a substantive procedure.

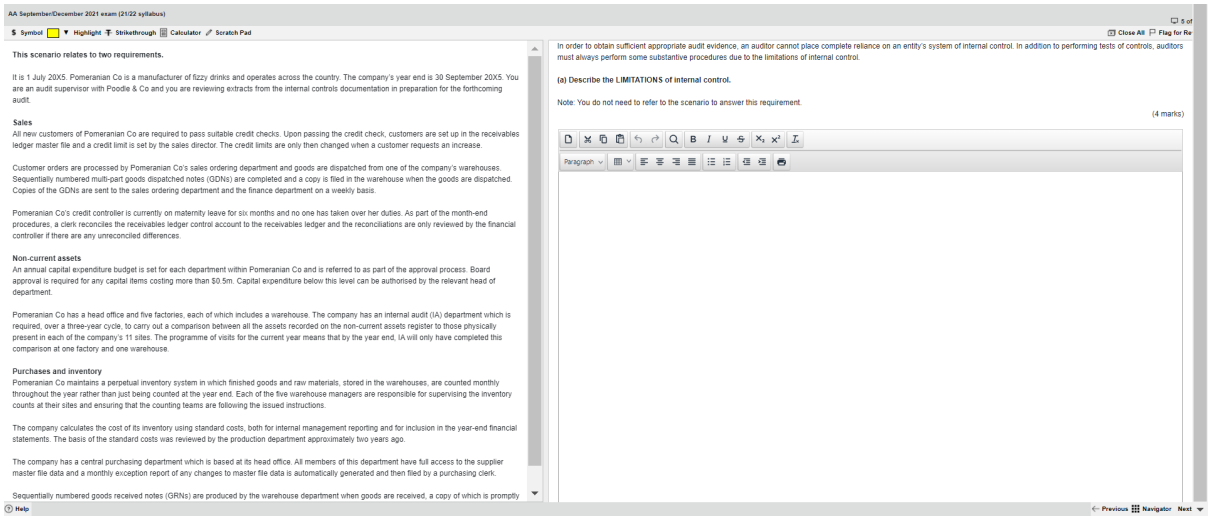
In many substantive procedure questions analytical procedures can be an important source of evidence. However, for one off types of expenditure such as development expenditure, analytical review is unlikely to be useful. The scenario clearly identified that development expenditure commenced on 1 November 20X4 and there was no information in the question to suggest that there was a balance in the prior year.

Candidates who focused on 'casting the development expenditure and agreeing to financial statements', 'agreeing costs to invoices/payroll records', 'recalculating the amortisation charge and confirming that it covers May to August 20X5' and 'reviewing the disclosure is in accordance with accounting standards' were able to gain credit.

Where substantive procedures are required for an account balance subject to an accounting standard then considering the rules of the standard can help in generating targeted substantive procedures. IAS® 38 Intangible Assets prescribes a series of criteria which must be met in order for costs to be classified as development expenditure. Therefore, tests based on these such as 'reviewing cash flow forecasts to assess if Peach Co has enough resources to complete the project' would have been awarded credit.

Future candidates should take the time to read the question requirements carefully and spend time thinking about what is needed prior to producing an answer.

Pomeranian Co



This 20-mark question is based on Pomeranian Co, a manufacturer of fizzy drinks. This question tests candidates' knowledge of the limitations of internal control, deficiencies and control recommendations in a multi-cycle scenario.

Requirement (a) – 4 marks

Describe the LIMITATIONS of internal control.

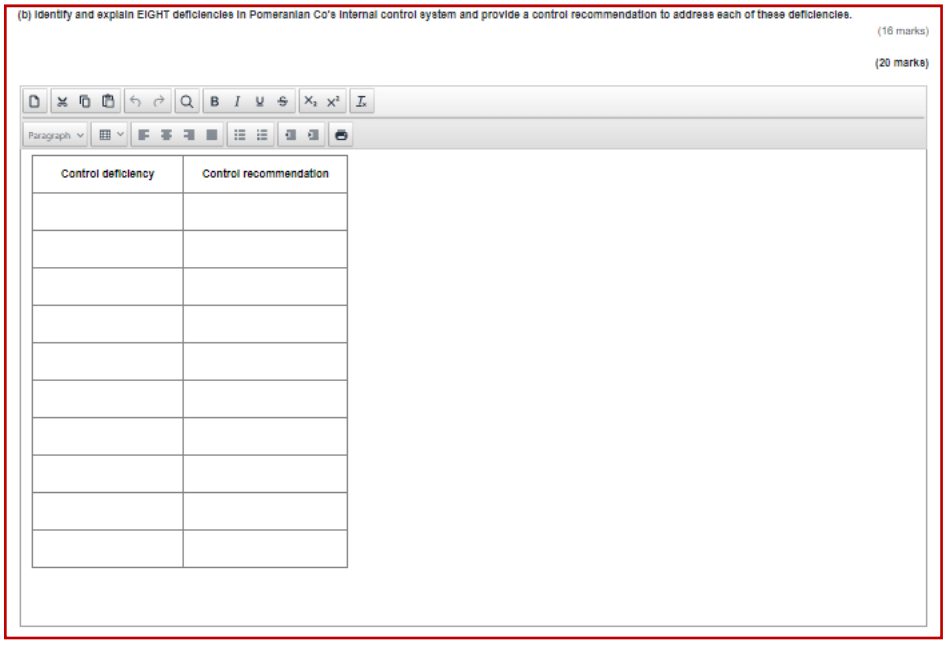
As with the knowledge requirement in Peach Co, it is important that candidates understand exactly what the question is asking for, especially where candidates should be aiming to score full marks. For this session candidates were required to describe limitations of internal control for 4 marks. As the requirement verb was 'describe' candidates need to ensure that they write enough detail in their answers. Simply providing a few words such as 'human error' is not enough for a description. Candidates therefore need to consider whether they have developed the point sufficiently.

When attempting this requirement, it is important to identify the limitation and then provide some form of description of how this is a limitation. ½ mark was credited for the identification of the limitation and ½ mark for the description of it. For example, ½ mark would have been awarded for 'management override of control' and ½ mark for going on to say 'management using their position to ignore the controls in place for their own personal benefit'.

It is also important that candidates pay attention to any elements of the requirement which are highlighted. In this session the word 'limitations' was in capitals. This was specifically done to focus candidates' answers, so that they would not provide answers which related to other aspects of internal control. Additionally, there was a note under the requirement which stressed that the scenario did not need to be referred to in answering this requirement. Unfortunately, in this session many candidates ignored the word 'limitations' and the note and incorrectly focused on types of controls such as authorisation, components of internal control or provided control deficiencies from the scenario. Notes and key words highlighted in requirements are there to guide candidates and to help, do not ignore them.

It is imperative that future candidates ensure that they devote adequate time to learning the knowledge areas of the syllabus as well as practicing this style of knowledge question. Good example questions to practice are Castle Couriers Co from the 'Sample March/June 2021 Questions', Swift Co from the 'Sample September/December 2020 Questions', Snowdon Co from the 'Sample March/July 2020 Questions', Amberjack Co from the 'Sample September/December 2019 Questions' and Freesia Co from the 'Sample March/June 2019 Questions'.

Requirement (b) – 16 marks



Identify and explain EIGHT DEFICIENICES in Pomeranian Co's internal control system and provide a control recommendation to address each of these deficiencies.

Marks are awarded for identification of deficiencies (½ mark each), explanation of the implication of the deficiency to the company (½ mark each) and an appropriate control recommendation to address each deficiency (1 mark each).

The scenario will typically contain more than the number of deficiencies required and it remains important that candidates plan their time carefully and only attempt to list the required number of points. Continuing to apply good exam technique and time management skills is critical.

The first step in tackling a deficiencies question such as Pomeranian Co is to read through the whole scenario in full. This gives an understanding of what the potential answer points are as some deficiencies are easier to explain than others. As with Peach Co, candidates may find it helpful to use the highlight function at this stage to mark the key points in the scenario which indicate a deficiency. Having looked at the whole scenario then candidates should re-read it, select the points they are to address in their response and then draft their answer as they go along. Do not be daunted by the length of the scenario, be methodical and keep re-reading the requirement to stay focused. In a multi-cycle question such as Pomeranian Co there is likely to be a good cross section of points across each of the cycles presented.

In identifying deficiencies, it is important to record what the actual deficiency from the scenario is. Candidates appear to be able to pick the relevant fact from the scenario but often fail to describe it in terms of a deficiency. For example, candidates identified from the scenario 'the finance clerk matches the invoices to the relevant purchase order and then passes the documents to the finance director for authorisation prior to input.' This is the relevant information from the scenario however, the actual deficiency which should have been derived from this information was that the invoices are only agreed to orders and not to goods received notes before being authorised for payment. A reference to the lack of checking to the goods received note would be required for the ½ mark available for identification of the deficiency.

Candidates must also be careful not to identify irrelevant deficiencies. For example, in the scenario it stated that the company maintains a perpetual inventory system. This in itself is not a deficiency, as it is a perfectly acceptable method for recording inventory as long as the process is well-managed and records are regularly updated and checked. Therefore, responses which identified this method as a deficiency and recommended a full year-end inventory count did not gain credit. Other answers incorrectly stated that the company should not value inventory using standard costs, that asset verifications should be undertaken over one year (which would not be practical) and that clerks were too junior to complete any tasks irrespective of the level of supervision or review by senior staff.

Having identified deficiencies, candidates are required to explain the implication to the business to be awarded credit. For example, a valid explanation for the deficiency 'only assets from two of the eleven sites will have been physically verified by the year end' (identification ½ mark awarded), would have been 'this could result in obsolete assets not being identified in the asset register in a timely manner.' The explanation of the deficiency must be sufficiently detailed and specific to the deficiency identified. Continuing with the example of the physical verification of assets deficiency, answers which just stated 'assets may be misstated' would not have gained credit as it does not fully explain **how** assets may be misstated.

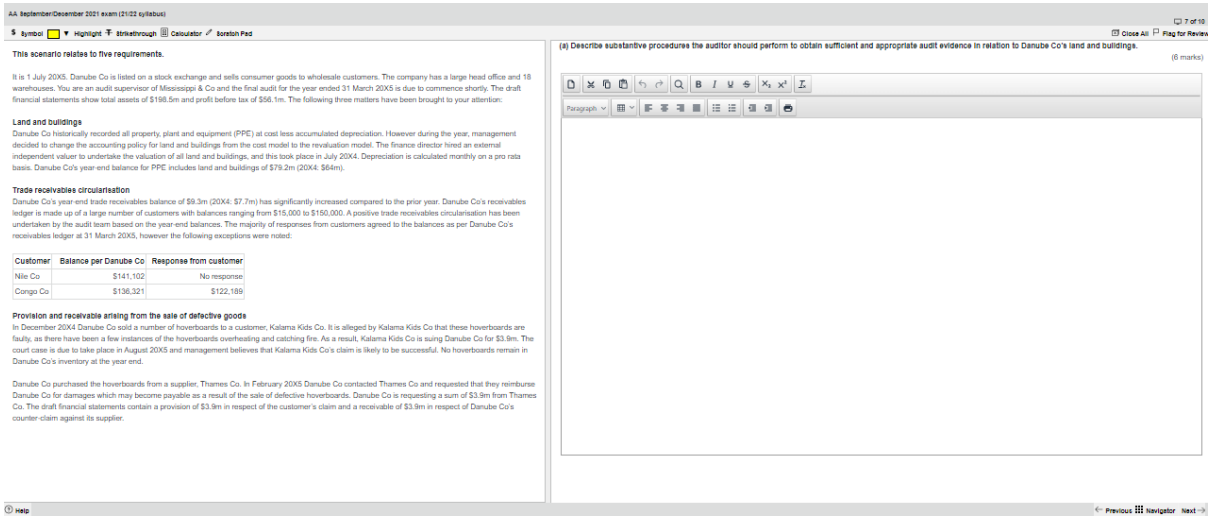
Many candidates explain deficiencies by stating that 'this will result in fraud/error'. This explanation is not sufficiently detailed as all deficiencies can lead to increased fraud and error. A clear understanding of how the deficiency will result in fraud and error is needed. In Pomeranian Co this applied particularly to the deficiency of 'receivables ledger control account reconciliation is only reviewed where there are unreconciled differences.' The explanation needed to focus on how the receivables balance could contain errors rather than a generic comment relating to 'an increased risk of fraud and error.'

The last part of the requirement is for candidates to describe control recommendations. To gain the 1 mark available it is imperative that the descriptions of the controls are detailed enough. Details to consider would include what needs to be done, who does it need to be carried out by and how often does this need to take place. Additionally, recommendations must be actions rather than just objectives. Recommendations which are phrased as 'ensure that….' are unlikely to gain much credit as they set out what needs to be achieved rather than the process or procedure that needs to be put in place.

Candidates need to take care to ensure that recommendations are well described, clearly address the specific control deficiency identified and are practical suggestions. Many candidates often just repeat the converse of the deficiency, and to obtain the recommendation mark more detail is needed. For the credit limits deficiency, the recommendation of 'the credit limits should be regularly reviewed' would only gain ½ mark. To achieve a full mark the recommendation would need to state who should undertake this review, for example the sales or finance director. Additionally, for the deficiency relating to the warehouse managers supervising their own counts, simply recommending that 'a suitable person should supervise the count' was not sufficient. To gain full credit the recommendation would need to specify who this person should be. In this case, an appropriate suggestion would be a member of the internal audit department.

Good questions to practice include Castle Couriers Co from the 'Sample March/June 2021 Questions', Snowdon Co from the 'Sample March/July 2020 Questions', Amberjack Co from the 'Sample September/December 2019 Questions', Freesia Co from the 'Sample March/June 2019 Questions' and Camomile Co from the 'Sample September/December 2018 Questions'.

Danube Co



This 20-mark question is based on Mississippi & Co, an audit firm due to commence the audit of Danube Co, a listed company which sells consumer goods to wholesale customers. This question tests candidates' knowledge of substantive procedures and auditors' reports.

Parts (a) – (c) examine substantive procedures for land and buildings, trade receivables circularisations and a provision and receivable arising from the sale of defective goods. Requirement (a) is for 6 marks, (b) for 4 marks and (c) for 5 marks and time allocation should be based on 1.8 minutes per mark. Therefore, the available time should be split as follows; 11 minutes for requirement (a), 7 minutes for (b) and 9 minutes for (c).

1 mark is available for each well-explained procedure therefore candidates should aim to produce six tests for requirement (a), four for (b) and five for (c). Candidates must strive to understand substantive procedures and apply good exam technique. This includes tailoring procedures to the specific requirements of the question. Additionally, tests must be sufficiently detailed noting clearly which source document should be used. For example, tests such as 'review disclosures' would only score ½ mark. To score a full mark the procedure should go on to say 'in accordance with accounting standards/relevant legislation.' Also, recommending 'obtain a written representation' without explaining what for will not generate any marks.

Requirement (a) – 6 marks

Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Danube Co's land and buildings.

The scenario for this requirement detailed that the company had changed its accounting policy for land and buildings from the cost model to the revaluation model and that a revaluation of all land and buildings had taken place during the year. As is the case for Danube Co, it is important to consider what issue the scenario focuses on when looking at the question requirement. Here, the revaluation is an important factor. In other cases, the focus is provided in the requirement. For example, the question requirements can ask for procedures which relate to specific assertions

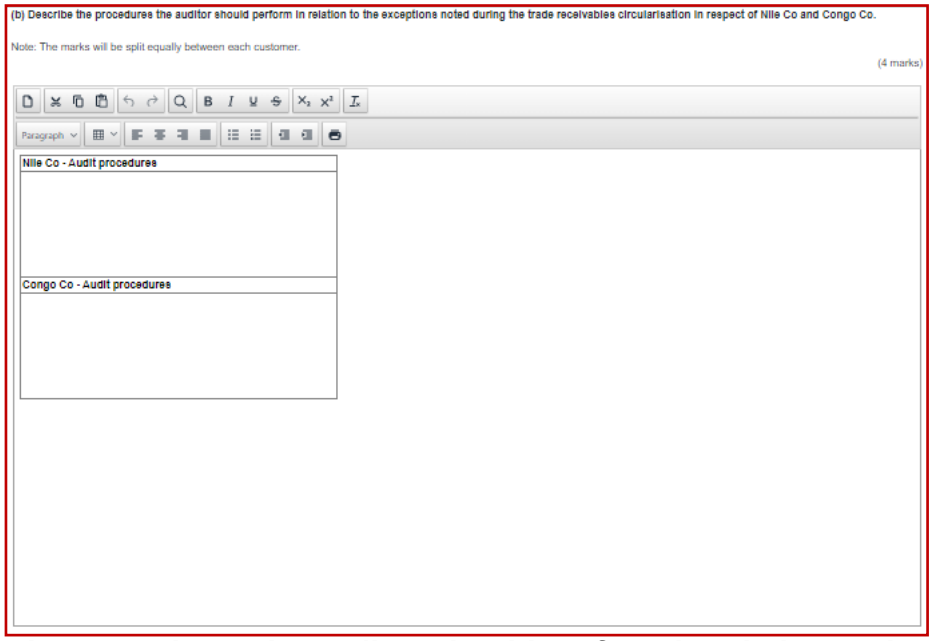
such as valuation or completeness. Where this is the case, care must be taken to ensure that any substantive procedures listed only relate to this assertion.

Spending time understanding the issue and carefully reading the question requirement ensures that any procedures listed are tailored and more likely to score marks. As the requirement was for land and buildings then the procedures need to focus on this specific category of property, plant and equipment (PPE) rather than focusing on all types of PPE. Procedures such as agreeing the revaluation to a valuation report and considering the independence and experience of the valuer would gain credit. However, also note that more straightforward procedures such as casting the schedule of land and buildings, recalculating depreciation and physically verifying the land and buildings would also have been relevant.

Care must also be taken when requesting written representations. These should be restricted to areas where the auditor is relying on management's judgement or there is little independent evidence available.

When generating substantive procedures, it is important to ensure the tests have sufficient detail and are clear. For example, 'recalculate the depreciation' would be awarded ½ mark. For the full mark candidates should make some reference to the basis of the calculation. An appropriate response would be to add 'and confirm depreciation is based on the correct valuation/pro rata'.

Requirement (b) – 4 marks



Describe the procedures the auditor should perform in relation to the exceptions noted during the trade receivables circularisation in respect of Nile Co and Congo Co.

In common with part (a) it is important to carefully consider the requirement and review the scenario to understand what issue is being addressed. In this case the scenario indicated that a receivables circularisation had been undertaken and two customer accounts, Nile Co and Congo Co, had exceptions. Nile Co had not responded and Congo Co had confirmed a balance lower than the balance contained within Danube Co's receivables ledger.

The substantive procedures which will gain credit are those which are targeted on resolving the exceptions. In tackling this requirement, it is important to note that there are four marks available for two exceptions, therefore each exception relates to two marks and two detailed procedures per exception would be required to maximise marks. Information regarding the mark split was provided in a note to the requirement.

In approaching this question candidates should consider what circumstances could have given rise to each exception and suggest procedures to address this. In the case of Nile Co, as no response has been received then the logical first step would be to 'send a follow up confirmation request with the clients permission.' If no response is received, then candidates should consider what alternative procedures could be adopted, such as 'review after date cash receipts to confirm the year end receivable,' to gain the other available mark.

For Congo Co the issue relates to a difference of $14,132. Candidates need to consider why the customer would have a lower sum owing than Danube Co has recorded. The two most logical reasons would be due to cash in transit at the year end from Congo Co to Danube Co or due to goods in transit from Danube Co to Congo Co. One audit procedure to test each of these reasons would result in two marks. In generating tests for in transit items it is important to list exactly what records will be reviewed and whether these are before or after the year end. Failing to be specific would result in full marks not being awarded. Candidates need to be clear that for cash in transit, the post year-end cash book would be reviewed and for goods in transit, the pre year-end goods dispatched notes would be tested.

Requirement (c) – 5 marks

Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to the PROVISION and the RECEIVABLE arising from the sale of defective goods.

Good exam technique is important for a requirement like this. The scenario for this requirement detailed that Danube Co had sold some hoverboards to a customer and it was alleged that these were faulty and the customer was therefore suing Danube Co. However, Danube Co was counter claiming against its supplier that had supplied the hoverboards. Therefore, a provision for the claim from the customer and a receivable for the counter claim on the supplier were recognised in the draft financial statements. It is important to consider how the issue in the scenario links to the question requirement. In this case the requirement clearly relates only to the provision and receivable and so candidates should only provide substantive procedures for these two balances.

A significant minority of candidates also provided tests relating to the defective inventory of hoverboards. However, the scenario clearly stated there were no hoverboards in inventory at the year end and the question requirement only related to the provision and receivable. Candidates must carefully read the information in the question and tailor their answers accordingly.

While some knowledge of accounting for legal claims would have been helpful the key here is to think logically. It is possible to produce a good answer by thinking through the issues which are relevant for any provision, for example whether it

should be recognised and if so, at what amount. Procedures can then be designed to address these issues using the information from the scenario to add detail.

Procedures which gained credit in this session included 'reviewing customer/supplier correspondence', 'reviewing the post year-end cashbook for payments made/received and agreeing this to the financial statements' and 'obtaining written representations on management's view of the outcome of each of the claims.' The most common incorrect procedure, other than those relating to inventory, was 'to recalculate the provision.' For a single claim/counter claim this would not be appropriate as there is nothing to calculate.

Good examples of questions to practise are Purrfect Co from the 'Sample March/June 2021 Questions', Sagitarrii & Co from the 'Sample September/December 2020 Questions', Encore Co from the 'Sample March/July 2020 Questions', Spadefish Co from the 'Sample September/December 2019 Questions', Hyacinth Co from the 'Sample March/June 2019 Questions', Jasmine Co from the 'Sample September/December 2018 Questions' and Gooseberry Co from the 'Sample March/June 2018 Questions'.

Requirement (d) – 5 marks

Describe the factors which the audit engagement partner would have considered in determining that this issue is a KAM; and describe the content of the KAM section of the auditor's report for Danube Co.

Although auditors' reports feature regularly in the AA exam, there are several ways in which they can be examined, and candidates must be prepared for a range of question types on audititors' reports. For this session the requirement for 5 marks tested the factors to be considered when determining KAM and the contents of the KAM section.

The starting point with this type of requirement is to consider what knowledge a candidate has with regards to ISA 701 Communicating Key Audit Matters in the Independent Auditor's Report. Knowledge of this standard will help in considering what influences the decision as to whether an issue is a KAM or not. Although the scenario related to the provision and receivable from the sale of defective goods, many of the marks available could be obtained for stating basic points derived from the ISA. Candidates should be reminded of the importance of being familiar with all of the ISAs relevant to section E of the syllabus.

Based on the marks available, candidates should focus on two to three points that the engagement partner would consider. These would include the level of risk relating to this issue, whether it would be reported to those charged with governance and the level of judgement involved.

The next step would be to move onto the content of the KAM section of the auditor's report. Here candidates should consider reporting WHAT the issue is, WHY the issue is considered a KAM and HOW the issue was addressed during the audit. One point for each of these three would have been sufficient to maximise the available marks for this part.

This session it was clear that many candidates had not revised the area of KAM and as a result were unable to tackle this question requirement. Common incorrect

answers attempted to answer this question as if it related to a modified audit opinion. It is important to revise all aspects of auditors' reports included in the syllabus and candidates should not simply assume that the focus of the question will be a modified opinion.

Auditors' reports are a core area of the syllabus and knowledge of the ISAs in this area is imperative. Good questions to practice are Purrfect Co from the 'Sample March/June 2021 Questions', Sagitarrii & Co from the 'Sample September/December 2020 Questions', Encore Co from the 'Sample March/July 2020 Questions', Jasmine Co from the 'Sample September/December 2018 Questions' and Gooseberry Co from the 'Sample March/June 2018 Questions'.