



# Examiner's report

## F8 Audit & Assurance

June 2015

### General Comments

There were two sections to the examination paper and all of the questions were compulsory. Section A consisted of twelve multiple choice questions (one and two marks each) which covered a broad range of syllabus topics. Section B had four questions worth 10 marks each and two longer questions worth 20 marks, each testing the candidates' understanding and application of audit and assurance in more depth. The following paragraphs report on each section and focus on some of the key learning points.

### Specific Comments

#### Section A

It was very pleasing to see that once again almost all candidates attempted all of the questions. Candidates preparing for the next examination of F8 are advised to work through the pilot paper, past exam papers and sample questions discussed here 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 F8 syllabus, rather than attempting to question spot.

The following two 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.

#### Sample Questions for Discussion

##### Example 1

**Which of the following substantive procedures provides evidence over the COMPLETENESS of non-current assets?**

- A** Select a sample of assets included in the non-current asset register and physically verify them at the client premises
- B** Review the repairs and maintenance expense account to identify any items of a capital nature
- C** For assets disposed of, agree the sale proceeds to supporting documentation and cash book

This question tested candidates' knowledge of substantive procedures and their understanding of which financial statement assertion was being verified. This question was answered incorrectly by the majority of candidates.

When assessing substantive procedures it is imperative that candidates are able to differentiate between the assertions being tested. This skill was also required in answering long question 6b. The three answer options provided were all valid substantive procedures for auditing non-current assets, however they each focused on a different assertion. The key to passing this type of question was to identify what assertion each procedure was testing and to correctly identify the procedure that would test for completeness.

Procedure A involved physical verification of non-current assets and the direction of the test was from the register to the actual asset. If the physical asset could not be verified then non-current assets

would be overstated, hence this is a test for existence. Procedure C focused on verifying the amount of disposal proceeds and hence addressed the assertion of valuation.

Procedure B originated from the repairs and maintenance account and focused on identifying any items of a capital nature. If items were included in the repairs and maintenance account instead of being capitalised then this would result in non-current assets being understated or incomplete. Therefore the correct answer was B.

Future candidates should take note that they must be able to identify correctly the type of procedure given, and for substantive tests they need to be able to identify the assertion being tested.

## Example 2

**Which TWO of the following controls of a sales system ensure that all goods despatched are completely and accurately invoiced?**

- (1) Good despatched notes are matched to sales invoices
- (2) Sales invoices are sequentially numbered
- (3) Sales invoices are matched to customer orders
- (4) Regular review of unfulfilled orders

- A** 1 and 2
- B** 2 and 4
- C** 2 and 3
- D** 1 and 4

This question tested the area of internal control objectives and control procedures and was incorrectly answered by the majority of candidates.

The question required identification of controls which would address the sales cycle objective of ensuring that all goods despatched were completely and accurately invoiced. Hence the controls needed to identify if any goods could be or had been despatched but not invoiced.

Procedure 1 focused on goods which had been despatched and required the GDN to be matched to the sales invoice. Hence this control would address the given sales objective as it would allow for any GDNs that did not have a corresponding invoice to be identified. Procedure 2 confirmed the completeness of sales invoices; this control would ensure that all invoices had been recorded. However, it would not give assurance that all goods which had been despatched had been invoiced. Procedure 3 does not confirm that the goods had actually been despatched as there is no check to the GDN. Procedure 4 focused on identifying any unfulfilled orders, a possible reason for an order showing as unfulfilled is because the goods had been despatched but the accounting records are incomplete as the sales invoice has not been raised.

The correct answer was therefore D, options 1 and 4.



## Section B

### Question One

This 10-mark question required identification and explanation of five ethical threats faced by the auditor of Willow and how these threats could be reduced. This question was answered well by most candidates.

In order to score the identification  $\frac{1}{2}$  marks, candidates were required to identify the fact from the scenario which may affect independence and from that identify which category of ethical threat this created. The explanation  $\frac{1}{2}$  marks were awarded if candidates then went on to explain how this may affect the auditor's independence. Many candidates did not explain the threats correctly or in sufficient detail, often stating "this will reduce independence and objectivity", this is not an explanation of **HOW** objectivity could be affected.

For example, many identified the fact from the scenario that Bethan Norman was being asked to take on the role of independent review partner, despite having been the engagement partner for seven years. Those candidates that went on to correctly identify this as being a familiarity threat were awarded the identification  $\frac{1}{2}$  marks. The explanation  $\frac{1}{2}$  marks were given if candidates explained that as a result of the long standing relationship Bethan may be too trusting or insufficiently sceptical when reviewing the audit work. Just identifying the fact would not score any marks, as the identification of the ethical threat was required along with an explanation.

For several points many candidates incorrectly identified the ethical threat, for example many classified helping to recruit a new non-executive director as an advocacy threat when it was actually a self-interest, familiarity or intimidation threat. Candidates must be able to correctly identify the type of ethical threat created in the circumstances and are reminded that the ACCA Code of Ethics and Conduct is an examinable document for F8.

Some candidates assumed that an issue had to be identified for each category of ethical threat; self-review, self-interest etc. This resulted in them trying to identify a situation from the scenario to fit each type of threats. This is not the correct approach as it is unlikely that the scenario will be based around one of each of the five ethical threats.

The second part of this question required candidates to suggest safeguards to reduce the ethical threats identified. Candidates' performance was generally satisfactory although some answers tended to be far too brief or impractical. For example for the threat of the audit manager joining the client, the response given by some candidates was "forbid the manager from leaving and joining the client," this is not a valid option. Also far too many candidates gave "resign as auditors" as the solution to any threat. Resignation is an option for auditors, but it is usually the last resort, and was not appropriate for any of the ethical threats in this question.

It was pleasing that many candidates set their answer out in two columns being ethical threat and response. This ensured that candidates had sufficient different points for the marks available.

### Question Two

This 10-mark question covered the topics of internal control components and tests of control.



Part (a) for five marks asked candidates to identify and briefly explain the components of an entity's internal control as per ISA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*. Candidates' performance was mixed on this question with many not even attempting it.

This was a knowledge based question focusing on this important area of ISA 315. There were some candidates who had clearly revised this area and were able to confidently identify the five components and explain what they related to. Some candidates were confused by "information systems" and incorrectly related this solely to a computer environment. Many candidates were only able to identify the components and either did not provide an explanation or it was incorrect. Also a significant minority of candidates explained the components from the perspective of what this meant for the audit firm rather than the company.

In addition a significant minority of candidates did not understand the question requirement, or did not have sufficient technical knowledge of this area and so instead of providing components, such as, control environment and control activities, focused on providing a list of internal controls such as authorisation or segregation of duties controls.

Part (b) for five marks required candidates to describe a test of control to assess whether five controls identified in the scenario were operating effectively. Candidates performed well on this question.

Weaker candidates wasted time by writing out the five controls from the scenario; there were no marks available for this. In addition a significant minority of candidates gave substantive procedures rather than tests of control. This was particularly the case when testing the control of internal audit undertaking physical verification of assets. Many candidates suggested "the external auditor should undertake a physical verification," this is a substantive procedure. Candidates are again reminded that a test of control should focus on allowing the auditor to verify if the client's control is operating as stated. In this instance the auditor should be focused on gathering evidence to demonstrate that internal audit has actually undertaken the physical verifications.

Furthermore some of the tests provided were vague or incomplete. For example "agreeing the serial numbers on the assets" but failing to agree these numbers to the non-current assets register. Also "observation" while a valid audit procedure, is not always the most appropriate or effective method of testing controls.

### **Question Three**

This 10-mark question informed candidates about issues that had been identified during a review of the files for two existing clients. Candidates were required to make an assessment of the materiality of each issue, provide a procedure to resolve each issue and discuss the impact on the audit report if each issue remained unresolved. Performance was satisfactory on this question, with an improvement in candidates' performance compared to the last time this style of question was examined.

The issues presented in the scenario included an outstanding receivable at Palm and non-attendance at the inventory count of Ash and the majority of candidates were able to identify and discuss the matters appropriately. In addition most candidates correctly identified and calculated that each issue was material. Some candidates launched straight into assessing materiality without discussing the issue and hence missed out on the available discussion marks for each issue.



A number of candidates when discussing the issue focused on whether the issues were adjusting or non-adjusting events rather than a risk of overstated receivables and failing to obtain sufficient and appropriate evidence over the completeness and existence of inventory.

With regards to procedures to undertake to resolve each issue, candidates seemed to especially struggle with Ash. The scenario stated that it was not possible to undertake another full inventory count, however many candidates ignored this and still suggested “the company should be told to undertake an inventory count”. This seems to indicate a failure by candidates to read the scenario. Other incorrect procedures involved “contacting the previous auditors” or “reviewing the competence of internal audit” rather than reviewing the results of the attendance by internal audit at the inventory count. Candidates performed better on auditing Palm; however some candidates incorrectly suggested “obtaining management written representations” or “contacting the customer directly to ask if they will pay”.

Performance on the impact on the audit report if each issue remained unresolved was better than in previous exam diets. Many candidates were able to identify the type of audit report modification required and attempt to describe the impact on the audit report. The most common omission was the need for a basis for qualified opinion paragraph.

Additionally a minority of candidates ignored the question requirement to only consider the audit report impact if the issue was unresolved. Lots of answers started with “if resolved the audit report .....” this was not required and no marks were available for this assessment.

#### **Question Four**

This 10-mark question was based on a manufacturer of bespoke furniture, Cherry Blossom Co (Cherry). This question tested candidates’ ability to identify and explain five deficiencies and provide recommendations for Cherry’s purchasing system.

This question was answered very well and candidates were able to confidently identify five deficiencies from the scenario. However, some candidates did not always adequately explain what the deficiency meant to the company. In addition some deficiencies were incorrect, such as “the junior clerk being too junior to process invoices”. Candidates should ensure that they consider the implication of the deficiency and to identify the issues that will have a significant impact on the company.

The scenario contained significantly more than five deficiencies; stronger candidates considered all of the deficiencies and selected the five they could describe in most detail, rather than the first five in the scenario. Unfortunately some candidates provided more than the required five deficiencies. Candidates are again reminded that only the best five can be awarded credit and therefore spending time providing more points can add to time pressure on later questions. Candidates should ensure that they apply appropriate exam technique to these types of requirements and are planning their answer and identifying the five best points before writing their answer.

The requirement to provide controls was, on the whole, well answered. Most candidates were able to provide good recommendations to address the deficiencies; however some of these recommendations were too brief. In addition some recommendations failed to address the deficiency or were unrealistic.



It was pleasing that many candidates set their answer out in two columns being deficiency and recommendation. However, those who explained all of the deficiencies and then separately provided all of the recommendations tended to repeat themselves and possibly wasted some time.

### Question Five

This 20-mark question was based on a pharmaceutical company Sycamore Sciences Co (Sycamore). This question tested the areas of fraud and error, audit risks and responses and review engagements.

Part (a) for four marks required an explanation of auditor's responsibilities in relation to the prevention and detection of fraud and error. This question was answered unsatisfactorily and candidates need to be better prepared to tackle questions on core auditor responsibilities.

The question required candidates to discuss the auditor's responsibilities in this area; it did not require an explanation of directors' responsibilities. Unfortunately many candidates wasted time providing this and there were no marks available for this. In addition some answers strayed into providing procedures for detecting fraud and error rather than just addressing responsibilities. Candidates are again reminded to read the question carefully and to ensure that they are answering the question that has been set.

The majority of candidates were able to gain marks for reporting fraud to management or those charged with governance, for the auditors' general responsibility to detect material misstatements caused by fraud or error or that the auditors are not responsible for preventing fraud or error.

Part (b) for twelve marks required an identification and description of six audit risks from the scenario and the relevant auditor's response for each. Performance on this question was mixed and performance in relation to this core area of the syllabus remains overall disappointing.

The scenario contained significantly more than six risks and so candidates were able to easily identify enough risks for the marks available. Candidates who scored well in this question went on to describe how the point identified from the scenario was an audit risk by referring to the assertion and the account balance impacted.

As in previous diets, a significant number of candidates tended to only **identify** facts from the scenario such as "the previous finance director had been claiming fraudulent expenses from the company" but **failed to describe** how this results in an audit risk, thus limiting the marks that can be scored to  $\frac{1}{2}$  marks. To gain the full 1 mark candidates needed to refer to the risk of other fraudulent expenses being claimed resulting in an impact on profit, as the financial statement impact must be referred to. Only by connecting the fact from the scenario to the relevant assertion and area of the financial statements will the candidate have adequately explained the audit risk.

Unfortunately many candidates yet again focused on business risks rather than audit risks, and explained the risk in terms of the impact on Sycamore rather than the financial statements risk and hence how it affects the auditor.

As in previous sittings, many candidates performed poorly with regards to the auditor's responses. Many candidates gave business advice, such as undertaking quality control procedures over inventory



to prevent the increased level of sales returns. In addition a significant proportion of candidates failed to appreciate that the inventory count had already occurred, hence auditor responses focused on procedures to adopt at the count were not relevant in the circumstances. Audit responses need to be practical and should relate to the approach (ie what testing) the auditor will adopt to assess whether the balance is materially misstated or not.

Once again this was due to a failure to read the scenario carefully. Candidates are given 15 minutes reading time and this should be spent reading the section B questions carefully and planning an appropriate response rather than attempting multiple choice questions.

Many candidates presented their answers well as they adopted a two column approach with audit risk in one column and the related response next to it. Future candidates must take note audit risk is and will continue to be an important element of the syllabus and must be understood, and they would benefit from practising audit risk questions.

Part (ci) for two marks required an explanation of the purpose of review engagements and how they differed to an external audit and (cii) for two marks tested the levels of assurance for audits and review engagements. Overall this question was answered unsatisfactorily.

Few candidates were able to explain the purpose of a review engagement and many candidates failed to score any marks for (ci). Where the question was attempted many candidates repeated points that were then given in (cii). Candidates performed better in (cii) and many produced clear and concise answers which addressed the levels of assurance for each specified type of engagements. A minority of candidates however just referred to positive and negative assurance without linking them back to the two types of engagements.

### **Question Six**

This 20-mark question was based on Hawthorn Enterprises Co and tested candidates' knowledge of financial statement assertions and substantive procedures.

Part (a) was for eight marks in total and comprised of (ai) which required four financial statement assertions relevant to classes of transactions and events and part (a(ii)) which required an example substantive procedure for each assertion identified which would be relevant to the audit of revenue. This question was unrelated to the scenario and was knowledge based, and candidates' performance was unsatisfactory.

Financial statement assertions are a key element of the F8 syllabus and so it was very disappointing to see that a significant minority of candidates do not know the assertions relevant to classes of transactions and events. A significant proportion of candidates provided existence and valuation which were irrelevant as these are assertions relevant to account balances. Where candidates did correctly identify the assertions they often failed to explain them adequately or did so with reference to assets and liabilities rather than transactions. Also many explanations were too brief or simply repeated the assertion, such as, "accuracy ensures the amounts in the financial statements are accurate".

A number of candidates provided example procedures which were not relevant when testing revenue, but instead focused on receivables or purchases. This can only be due to a failure to read the question requirement properly. In addition many procedures were vague or incomplete, such as agreeing goods despatch notes to sales invoices but not then agreeing the invoices to the sales day book. Also many of

the procedures were tests of control rather than substantive procedures. The direction of the occurrence and completeness tests were often confused resulting in incorrect procedures. The direction of occurrence tests should generally start at accounting records, whereas completeness procedures should begin at source documents.

The remainder of the question provided candidates with three short scenarios detailing matters that had been brought to attention prior to the audit fieldwork and candidates were expected to produce appropriate substantive procedures relevant to each matter. Part (bi) for three marks required substantive procedures in relation to auditing supplier statement reconciliations. Part (bii) for four marks required substantive procedures over the bank reconciliation and finally part (biii) for five marks required substantive procedures in relation to the existence and valuation of receivables. Performance on this question was unsatisfactory. A significant minority did not attempt all parts of this question.

Most candidates were unable to tailor their knowledge of general substantive procedures to the specific issues in the scenario and question requirements. Many candidates spotted the terms payables, bank and receivables and proceeded to list all possible tests for these areas. This is not what was required and this approach scored few or no marks. The scenario was provided so that candidates could apply their knowledge. However it seems that many candidates did not take any notice of the scenario at all. As addressed in previous examiner's reports candidates must strive to **understand** substantive procedures, learning a generic list of tests will not translate to exam success as they must be responsive to the scenario.

In part (bi) candidates needed to focus on testing supplier statement reconciliations rather than trade payables in general. The most common correct answer awarded credit was "agree the supplier statements to the payables ledger." Very few candidates scored more than 1 mark. Incorrect answers focused on calculating trade payables days or undertaking a payables circularisation.

In part (bii) many candidates focused on auditing the cash balance rather than the bank reconciliation. Hence answers such as casting the cash book, requesting a bank confirmation letter or counting the petty cash balance were not awarded any credit. Preparation of bank reconciliations is part of the F3 Financial Accounting syllabus and therefore candidates should have considered the items which are included as part of the bank reconciliation and focused on deriving tests to audit each component.

In addition to verify if unpresented cheques and outstanding lodgements were valid reconciling items, audit procedures should have focused on inclusion in the pre year-end cashbook and post year-end bank statements. Very few candidates demonstrated an understanding of this point.

In part (biii) stronger candidates were able to generate tests focusing on analytical review against prior year balances, review of aged receivables listing or discussions with management about an allowance for receivables. However, a significant proportion of candidates incorrectly suggested undertaking receivables circularisation, including the detailed steps required, this was despite the scenario clearly stating that the finance director had requested that a circularisation not be carried out.

The requirement verb was to "describe" therefore sufficient detail was required to score the 1 mark available per test. Candidates must provide enough tests as they should assume 1 mark per valid procedure. Candidates are reminded yet again that substantive procedures are a core topic area and they must be able to produce relevant detailed procedures.