



# Examiner's report

## F8 Audit and Assurance

### March 2016

#### General Comments

There were two sections to the examination paper and all the questions were compulsory. Section A consisted of 12 multiple-choice questions (one or two marks each), which covered a broad range of syllabus topics. Section B had four written questions worth 10 marks each and two longer written questions worth 20 marks each, testing the candidates' understanding and application of audit and assurance in more depth.

#### **Specific Comments**

##### **Section A**

It was pleasing to see that once again almost all candidates attempted all of the questions. Candidates preparing for the next F8 examination are advised to work through the pilot paper, past exam papers and the sample questions discussed below, 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 should be included in the overall audit strategy document?

- (1) Economic factors and industry conditions affecting the company
- (2) The nature, timing and extent of audit procedures
- (3) Management's responsibility for the financial statements
- (4) Determination of materiality in line with the ISAs

- A 1,2 and 4
- B 3 and 4
- C 1 and 4 only
- D 2 and 3

This question tested candidates' knowledge of the documents produced during audit planning. This question was the least well-answered multiple-choice question in the March 2016 paper by a significant margin. Candidates are advised to understand the specific information and planning documents that ISA 300 Planning an Audit of Financial Statements requires the auditor to produce in the planning stage of the audit. The audit strategy document contains the general information relating to planning the audit such as the financial reporting framework, industry specific reporting requirements and materiality considerations. The audit strategy document then guides the development of the audit plan; a much more detailed document that includes specific guidance on, for example, timetables, staff allocations and audit procedures.



(1) and (4) would be found in the audit strategy document as assessing the economic factors and industry conditions and also determining materiality are part of establishing the overall audit strategy.

(2) The detail of the audit procedures for each material class of transactions, account balance or disclosure would be included in the audit plan

(3) Confirmation of management's responsibility for the financial statements is contained in the letter of engagement.

Therefore the correct answer is C (1 and 4 only)

Future candidates should therefore understand the specific information included in both the audit strategy and the audit plan documents, as well as the matters included in an engagement letter.

#### Example 2

Which of the following substantive procedures would test the VALUATION assertion?

(1) Physically inspect a sample of non-current assets for evidence of damage

(2) Recalculate the depreciation charge for a sample of non-current assets

(3) Review board minutes for evidence of disposals and agree removal from non-current asset register

(4) Review the repairs and maintenance account for items of a capital nature

A 2 and 3

B 3 and 4

C 1 and 4

D 1 and 2

This question tested candidates' knowledge of substantive procedures and their understanding of financial statement assertions. This question was not well answered by candidates. When generating substantive procedures it is important that candidates are able to differentiate between the assertions being tested. The four substantive procedures listed are all valid procedures for auditing non-current assets, however only two focussed on the assertion of valuation. The key to passing this type of question is to identify what assertion each procedure is testing.

Procedure (1) physically inspecting a sample of non-current assets for evidence of damage is a test for valuation as it assesses the condition of the asset

Procedure (2) recalculating the depreciation charge for a sample of non-current assets also tests the valuation, as any inaccuracy in the depreciation charge would affect the carrying value of the asset

Procedure (3) reviewing the board minutes for evidence of disposals and agreeing the removal from the non-current asset register is a test for existence

Procedure (4) reviewing the repairs and maintenance account for items of a capital nature is a test for completeness

Therefore the correct answer was D (1 and 2)

Future candidates should take note that they must be able to correctly relate the type of procedure with its related assertion.

## Section B

The six written questions in Section B tested candidates understanding of the audit and assurance syllabus which is structured around the following topics:

- Audit framework and regulation
- Planning and risk assessment
- Internal control
- Audit evidence
- Review and reporting

### Audit framework and regulation

This area of the syllabus requires; an understanding of the functions of an audit, being able to distinguish between the scope of internal and external audit, and, an understanding of both corporate governance and professional ethics.

Performance in the scenario-based corporate governance question in the March 2016 exam was mixed. Candidates were asked to identify and explain a set number of corporate governance weaknesses from a scenario and provide relevant recommendations to address each weakness.

It is pleasing that candidates planned their time carefully and generally only attempted to list the required number of issues. Candidates were awarded ½ mark for each weakness identified and a further ½ mark if the candidate explained why this was a weakness. Candidates' identification and explanation of relevant weaknesses from the scenario was mixed, some candidates incorrectly identified matters as a weakness from the scenario suggesting that they were not wholly familiar with best practice corporate governance principles. One mark was available for each recommendation, however candidates often worded their recommendation as either a "statement" or an 'objective' rather than an "action" and so were often not awarded the recommendation mark. For example in response to the weakness that the board was not balanced many candidates stated as their recommendation that 'the board should be balanced' and hence did not score the recommendation mark as this is an objective and would not tell a company how to achieve this. To obtain the 1 mark for the recommendation candidates need to clearly state how this would be achieved, for example that to attain balance on the board two additional NED's should be appointed.

The presentation of candidates' answers was generally of an appropriate standard. Most used a two-column format using the first column to identify and explain the corporate governance weakness and the second column to give a recommendation to address the weakness. This enabled candidates who used this format to ensure they produced a full answer with an allocated recommendation for every identified weakness and to ensure they had enough points to score the marks available.

### Planning and risk assessment

This area of the syllabus requires an understanding of how the auditor obtains and accepts audit engagements, obtains an understanding of the entity and its environment, assesses the risk of material misstatement and plans an audit of the financial statements.

Questions on assessing audit risks tend to be scenario based; the candidates having to identify and explain the risks from a scenario and give an auditor's response to address the risks. Other questions in this area of the syllabus tend to be more factual, knowledge based questions and hence depends on the ability of students to recall their knowledge in the exam.

As noted in previous Examiner's Reports a fundamental factor in planning the audit of an entity is an assessment of audit risk, and this remains a highly examinable area. Audit risk questions typically require a number of audit risks to be identified (½ marks each), explained (½ marks each) and an auditor's response to each risk (1 mark each). Performance in the audit risk question in March 2016, as with many previous exams continues to be mixed.

The scenario contained more issues than were required to be discussed and it was therefore pleasing that candidates generally only attempted to identify the required number of issues as noted in the question. However a number of candidates incorrectly identified some matters from the scenario as audit issues and perhaps did not understand that an audit risk needs to be something that can result in a material misstatement in the financial statements. In addition, candidates often did not explain how each issue could impact on the financial statements and therefore were not awarded the explain ½ mark. To explain audit risk, candidates need to state the area of the accounts impacted with an assertion (e.g. cut off, valuation etc.), or, a reference to under/over/misstated, or, a reference to inherent, control or detection risk. Misstated was only awarded if it was clear that the balance could be either over or understated.

The provision of relevant auditor's responses continues to be a poorly attempted area and candidates are once again reminded to ensure that this area of the syllabus is adequately studied and practised. While an auditor's response does not have to be a detailed audit procedure, rather an approach the audit team will take to address the identified risk, the responses given were often either too weak (e.g. "discuss with management") or not always appropriate (e.g. "obtain written representations"). In addition, some candidates gave a response from the client's perspective i.e. a recommendation as to what the client should do to overcome the risk, as opposed to suggesting a response that the auditor could undertake.

It was pleasing to note that few candidates discussed business risks and concentrated their answers on the risk of a misstatement in the financial statements.

Further it was pleasing to note that many candidates presented their answers well using a two-column approach with audit risk in one column and the related response in the other column

There were two knowledge-based questions in this area of the syllabus in the March 2016 exam. One question was generally well answered with candidates demonstrating a reasonably good knowledge of the area tested. However the other question in this area was disappointingly answered. Candidates were often not able to distinguish the audit procedures that are undertaken at different times of the audit cycle i.e. distinguish between procedures undertaken at the planning visit with those of the interim and final audit visits. In addition candidates often did not appreciate how the work undertaken at one audit visit in the year can impact on the work at the subsequent later visit in the year.

**Internal control**

This area of the syllabus requires both an ability to describe and evaluate internal controls techniques and audit tests, and, also an ability to make appropriate recommendations.

Internal control questions typically require internal controls deficiencies to be identified (½ marks each), explained (½ marks each) and, often, to give a relevant recommendation to address the control deficiency (1 mark each). Internal control questions may also require a covering letter to management to accompany the list of deficiencies and recommendations. Internal controls questions remain a highly examinable area. In the March 2016 exam this question was disappointingly answered.

Candidates often could not identify some of the weaknesses from the scenario. In addition, some candidates incorrectly identified matters as ‘weaknesses’ when in fact the scenario was describing a normal and satisfactory business practice. Recommendations to address control weaknesses were also often disappointing. Candidate’s recommendations often were either poorly described, did not clearly address the specific control weakness identified or were impractical suggestions.

Candidates’ answers in March 2016 were often too brief and it appeared that candidates generally did not allocate enough time to this question. Candidates should plan their time carefully according to the mark allocation of each question. In the March 2016 exam candidates, for example, often spent a disproportionate amount of their time on one of the factual questions in Planning and risk assessment and not enough time on the scenario based Internal control question which had more than three times the number of marks available.

While it was pleasing to note that many candidates presented their answers well using a two-column approach with internal controls in one column and the related recommendation in the other column, many candidates did not provide a covering letter which was specifically requested in the question requirements. Two marks were available for a covering letter. Candidates are advised for future sittings to ensure that if a covering letter is required then they not only use a ‘letter format’ but also include the necessary disclaimers in their covering letter.

In addition to identifying and providing recommendations on internal controls candidates were also required to identify the control objectives of a part of a company’s system. This question was unsatisfactorily answered. Many candidates incorrectly listed either tests of control or controls for that part of the system. Also in some instances candidates correctly identified a control objective however for a different part of the system than was requested. Candidates are reminded that they should understand all the different aspects that make up a company’s internal control system.

**Audit Evidence**

This area of the syllabus requires a description of the work and evidence obtained by the auditor required 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 event. The performance in the March 2016 exam in this area was disappointing.

Most candidates were unable to tailor their knowledge of general substantive procedures to the specific issues in the question requirements. 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 – procedures must be tailored to the specific requirements of the question.

In addition candidates often did not structure their answers appropriately. If the scenario discusses events at two different companies it is expected that the specific audit procedures relevant for each company will be discussed individually, rather than answering the question with a list of general procedures.

In this area of the syllabus, candidates are also required to understand and evaluate Computer Assisted Audit Techniques. The performance in the March 2016 exam in this area was disappointing. Many candidates were not able to distinguish between audit software procedures (used for substantive testing) and test data procedures (used for controls testing) and candidates are advised to revisit this area of the syllabus.

### **Review and reporting**

This area of the syllabus requires an understanding of how consideration of subsequent events and the going concern principle can inform the conclusions from audit work and are reflected in the contents of the auditor's report, written representations and the final review and report.

Performance in March 2016, where the question involved discussing an accounting treatment from a scenario and identifying the impact on the auditor's report, showed a continued improvement by candidates compared with previous sittings. Questions historically in this area of the syllabus have required a discussion of the accounting treatment, a materiality calculation, an assessment of the type of audit report modification and the impact on the auditor's report. It was disappointing that candidates often did not discuss the accounting treatment, however it was pleasing that most candidates attempted to calculate the materiality of the issue in the scenario. Performance on the impact on the auditor's report was satisfactory and most candidates were able to identify if the issue required a modification and, if so, the type of modification required.

Identification of subsequent events is a key area in the audit review and finalisation. Candidates satisfactorily distinguished between adjusting and non-adjusting events and therefore stated the type of amendment required to the financial statements. However candidates' descriptions of relevant audit procedures to be performed in order to form a conclusion on the required amendments were often disappointing. Procedures were often not well explained e.g. 'review board minutes' would not be awarded credit as to obtain the mark available the candidate must expand on what specific evidence is being sought from the board minutes. Procedures also often included the recommendation to obtain a written representation letter. Candidates should be aware that they should limit this as a response to a request for audit procedures as this should not be used as a substitute for other evidence.