

# Examiner's report

## F8 Audit & Assurance

### September 2015



#### 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 and 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 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 are appropriate audit procedures to test for COMPLETENESS of trade payables at the year end?**

- (1) Review outstanding invoices in the purchase ledger greater than three months old and enquire of management whether they are valid outstanding liabilities
- (2) Perform supplier statement reconciliations for a sample of suppliers
- (3) Review bank statements for payments made after the year end to identify those payments relating to pre year-end liabilities
- (4) Select a sample of invoices in the purchase ledger at the year end and agree payments made to bank statements post year end

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

This question tested candidates' knowledge of audit procedures and their understanding of financial statement assertions. This question was incorrectly answered by the majority of candidates.

When assessing audit procedures it is important that candidates are able to differentiate between the assertions being tested. The four audit procedures listed were all valid procedures for auditing payables, however only two focussed on the assertion of completeness. Candidates are reminded that when testing for completeness the auditor is looking for instances of UNDERSTATEMENT. The key to passing this type of question was to identify what assertion each procedure was testing.



Procedure 1 focused on asking management whether old, outstanding purchase invoices already in the purchase ledger were valid; as the invoices were already included in the purchase ledger this test would not allow the auditor to identify understatement and hence this test addressed the assertion of existence. Similarly, procedure 4 vouching invoices, again already included in the purchase ledger, to post year-end payments also addressed the assertion of existence. Procedures 2 and 3 however both addressed the assertion of completeness. Procedure 2 performing supplier statement reconciliations allows the auditor to compare third party evidence to the purchase ledger to ascertain if all payables have been recorded at the year end. Procedure 3 reviewing post year-end payments and considering whether these relate to pre year-end liabilities allows the auditor to search for unrecorded year-end liabilities.

Therefore the correct answer was D - 2 and 3 only.

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

### Example 2

Amit & Co is finalising the audit of Triangle Co, which is the subject of a litigation claim. This will not be settled until after the audit report has been signed. If the claim is lost, this could cause doubt over the going concern status of the company. The directors have correctly disclosed this matter in the financial statements. The issue is considered material and pervasive.

Which audit opinion should be issued for Triangle Co?

- A Unmodified opinion with an emphasis of matter paragraph
- B Qualified opinion
- C Adverse opinion
- D Modified opinion with an emphasis of matter paragraph

This question tested candidates' knowledge of the auditor's report and its content when there is doubt over the company's ability to continue as a going concern. This question was incorrectly answered by a significant number of candidates. When answering questions on possible modifications to the auditor's report due to doubts over going concern, it is important that candidates consider two criteria: Firstly whether the matter is material only, or, whether it is material and pervasive. Secondly whether the disclosures on going concern have or have not been correctly made in the financial statements. The question clearly stated the conditions in relation to both of these criteria.

Answer B – qualified opinion: This does not meet the first criteria as a qualified opinion is given when a matter is material and not pervasive. The question states the matter is material and pervasive.

Answer C - adverse opinion: This correctly meets the first criteria as an adverse opinion is given when a matter is material and pervasive. However, it does not meet the second criteria as the question states that the directors have already correctly disclosed this matter.

Answer D – modified opinion with an emphasis of matter paragraph: A modified opinion would be given in this situation only if the auditor disagreed with whether adequate disclosure had been made of any material uncertainties affecting the going concern. The question states the directors have correctly disclosed the matter so therefore no modification to the audit opinion is necessary. Further, including an emphasis of matter paragraph does not constitute an opinion modification; it just draws the readers' attention to an important area disclosed in a note to the financial statements.



The correct answer is A: the auditor would not modify the opinion as adequate disclosure has been made, however they would include an emphasis of matter paragraph to draw readers' attention to this area of fundamental importance.

## Section B

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

- 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 purpose 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.

Questions regarding the function of an audit and distinguishing between internal and external audits tend to be more factual, knowledge based questions. Whereas questions discussing corporate governance and professional ethics tend to be based on a scenario and candidates are required to identify and explain the areas of importance from the scenario and then give recommendations for each issue.

The scenario-based ethics question in September 2015 was well answered by the majority of candidates and many proved able to identify and explain the requested number of ethical issues. As in previous sessions the best answers were those that identified the fact from the scenario which may affect independence and from that identify which category of ethical threat this created as set out in the ACCA Code of Ethics and Conduct. 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 planned their time appropriately and focused on providing the requested number of points in sufficient detail. One mark was available for each well explained issue. While many candidates were able to identify relevant issues from the scenario, a significant number of candidates continue to not explain the issues correctly or in sufficient detail, therefore most candidates scored  $\frac{1}{2}$  marks rather than one mark for each issue. In addition, some candidates copied out large sections of the scenario without necessarily realising that there can be two issues in one sentence in the scenario and hence therefore did not go on to explain the consequences of and provide a recommendation for each individually.

The recommendations to counter each issue were generally clear, however again candidates continue to provide recommendations that are too brief and impractical.

The presentation of candidates' answers was generally of an appropriate standard. The majority of candidates used a two-column format using the first column to identify and explain the threat and the second column to provide a safeguard to mitigate the threat. This enabled candidates who used this format to ensure they produced a full answer with an allocated safeguard for every identified threat 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 financial statements.

As noted in previous Examiner's Report; a fundamental factor in planning and assessing the risks of an 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 ( $\frac{1}{2}$  marks each), explained ( $\frac{1}{2}$  marks each) and an auditor's response to each risk (1 mark each). Performance in audit risk questions continues to be mixed.

Audit risk scenarios will always contain more issues than need to be discussed to score the marks available and there was evidence that candidates planning and exam technique in this area is improving with a majority of candidates generally focusing on identifying the required number of issues as noted in the question.

However, as in previous sittings, candidates often did not explain how each issue could impact on the financial statements and failed to explain why the issue identified was an audit risk. This resulted in many candidates not scoring the explanation  $\frac{1}{2}$  marks. To explain audit risk in sufficient detail, candidates need to state for each issue identified why it is a risk and the financial statement impact must be referred to. For example strong answers will explain how the issue could result in a balance being overstated, understated, misstated, misclassified, or, a going concern problem. 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.

The provision of relevant auditor's responses continues to be a poorly attempted area of the syllabus. While an auditor's response does not have to be a detailed audit procedure, rather it should set out an approach the audit team will take to address the identified risk, the responses given were often either too weak (eg "discuss with management") or not always appropriate (eg "obtain written representations"). Candidates are again reminded that written representations are not a substitute for audit evidence.

Candidates are reminded that audit risk questions may also require a calculation of relevant ratios that will allow the auditor to identify the key areas of risk in the financial statements. If this is required, as it was in September 2015, it is noted that candidates should only provide one ratio per area of the financial statements (eg either "inventory days" or "inventory turnover"), not include calculations of movements year on year (eg "revenue has increased by x%"), as while relevant in the discussion of risk will not score the marks for calculating appropriate ratios, and also come equipped with a calculator for the F8 exam.

It was encouraging to note that few candidates discussed business risks, an issue in many previous sessions, 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 effectively using a two-column approach with audit risk in one column and the related response in the other column

## Internal control

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

Internal control questions typically require internal controls deficiencies to be identified ( $\frac{1}{2}$  marks each), explained ( $\frac{1}{2}$  marks each) and, often, to give a relevant recommendation to address the deficiency (1 mark each). Occasionally, as in September 2015, candidates may be asked to identify internal control strengths as well as deficiencies. Candidates continue to perform well on internal control questions.



Candidates were able to confidently identify internal controls deficiencies from the scenario, however some candidates did not clearly explain the deficiency in terms of how it affects the business. The scenario in the exam will always contain more issues than required to be discussed and it was therefore encouraging that candidates generally applied effective exam technique and focused on providing well explained answers which identified the required number of issues as noted in the question.

A minority of candidates, rather than evaluating internal controls just formed a point of view as to how well the company was controlling its operations, and, also included more “social” factors such as “the motivational effect of having/not having a bonus system in force in a company” which was not required and does not answer the question.

Recommendations to address control weaknesses were on the whole well explained. Most candidates were able to provide good recommendations to address the deficiencies. However occasionally some of the recommendations did not clearly address the specific control weakness identified and candidates are again reminded to ensure that their recommendation is specifically tailored to the requirements of the scenario.

### **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 (“ISA”).

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. Performance in this area continues to be unsatisfactory. Candidates continue to prove unable to tailor their knowledge of general substantive procedures to the specific issues in the question requirement.

Candidates frequently described substantive procedures for a different class of transactions than had been specifically asked for in the question. 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.

This area of the syllabus can also include factual based questions in relation to the content of the ISAs. It was noted in the September exam that when definitions/terms, analytical procedures, reliance on internal audit and sampling were asked to be identified and explained, the majority of candidates identified them fairly well yet explanations were often unsatisfactory eg using the same word in their explanation as the term they are attempting to explain.

Audit evidence continues to be an area that requires more study and question practice

### **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 may need reflected in different types of audit opinion, written representations and the final review and the content of the independent auditor’s report.

Performance in September 2015, identifying from a scenario 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 an assessment of materiality and the impact on the auditor’s report. In September 2015 candidates were required to address these two areas based on information in a scenario. Some past questions have also asked for audit procedures to address each issue, however this was not required in the September



exam so it was disappointing therefore that some candidates spent valuable time describing audit procedures. Candidates are again reminded to read the question carefully and to respond to the question that is presented.

Most candidates attempted to calculate the materiality of the issues in the scenario. However a worrying number of candidates did not put the decimal point in the correct place for their materiality calculations and hence their calculations were incorrect. In addition some candidates calculated materiality without first discussing the issue and hence could not be awarded the available one mark in this area. Performance on the impact on the auditor's report was satisfactory, most candidates were able to identify if the issue required a modification and, if so, the type of modification required. An area where candidates struggled was failing to take into account whether disclosures of an issue had already been made in the financial statements and the consequent effect on this had on the report.

There was also some coverage of final review procedures at this sitting and candidates poorly understood the stages/types of final review procedures. Candidates need to be able to distinguish between completion procedures (such as going concern, subsequent events reviews) and overall review of financial statements procedures (such as a review of compliance with accounting standards and legislation).