



# Examiner's report

## Advanced Audit and Assurance (AAA) December 2019

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.

### General Comments

The examination consisted of two sections with all three questions being compulsory. Section A comprises a 50-mark case study style question set at the planning stage of the audit cycle. Section B contains two 25-mark questions, one of which is predominantly focused on section E of the syllabus, completion, review and reporting. The remaining 25-mark question can be drawn from any section of the syllabus.

### Approach and guidance

The aim of the syllabus is to analyse, evaluate and conclude on the assurance engagement and other audit and assurance issues in the context of best practice and current developments. The focus of the examination is to build on the knowledge candidates have learned in previous examinations, in particular Strategic Business Reporting (SBR) and Audit and Assurance (AA), in order to address more complex and judgemental situations which they may face in audit practice. Candidates should note that all the financial reporting standards which are included in the examinable documents for SBR are examinable in AAA. Candidates should ensure that they are fully conversant with the financial reporting standards covered by SBR to maximise their ability to effectively identify how audit risks may arise from these issues and propose effective procedures to address those risks.

When a candidate attempts examinations at strategic professional, it is vital that they are able to apply the knowledge they have gained through studying to the situations and scenarios in a given examination question. A common feature of weaker answers in this subject is the use of rote learned knowledge without application to a specific scenario. Such an approach does not demonstrate the skills which are required at this level to demonstrate audit competence. Producing answers to a past question which do not address the specific issues in the examination will take up valuable time without resulting in marks. Past question practice should be used to develop technique, analysis skills and time management rather than with the aim of producing the same answer in an examination where the scenario will be different. This is particularly a problem within Section A of the exam.

### Specific comments

#### Question One

This question was a planning question for a listed manufacturing company trading as a single entity. The overall format was similar to that in the December 2018 examination where candidates were initially asked to consider business risks and then in this case, also audit risks.

Part (a) required candidates to evaluate the specific business risks facing the company based on information given in the scenario. This section was well answered by candidates, and the majority used the information effectively to describe risks relating to the specific company in the question.

Often these candidates were able to score full or almost full marks. Weaker candidates produced generic risks which could affect any business and often were unable to adapt these to the business detailed in the scenario. In particular, this scenario included a unique selling point (USP) for the company which was highly successful, but many candidates suggested that the USP was a weakness and the company needed to move away from this in order to achieve economies of scale.

Part (b) asked candidates to evaluate audit risks facing the company and answers to this were mixed. Where a candidate had a strong knowledge of financial reporting standards, described why a risk could result in a material misstatement, and stated the impact on the financial statements as a result, high marks were achieved. Some candidates displayed a lack of knowledge of the underlying financial reporting rules despite most of the topics being relatively straightforward and some candidates also produced risks relating to previous questions rather than the one set. Particular weaknesses in financial reporting knowledge arose on the treatment of equity-settled share-based payments and the treatment of foreign currency for an international branch. However, many candidates were able to attain credit for topics such as inventory, provisions and assets held for sale. As usual candidates listing speculative risks were unable to achieve credit for those risks.

The information provided to candidates for this section included results from the preliminary analytical review prepared by the audit firm. These were provided by the audit engagement partner and thus deemed necessary for planning purposes. The presentation of the information with ratio analysis already prepared should have enabled candidates to save time calculating ratios and allow them more time to demonstrate their interpretation skills which are more relevant at this level. Unfortunately, many candidates appeared to struggle with this and spent time trying to perform further calculations on the ratios provided. A minority of candidates interpreted a lower level of profit growth in the current year as meaning the company was loss making. Some candidates did not appear to appreciate that the information was audit firm generated and wasted time speculating about client motives in presenting the information. It is important that candidates note the source of information and its purpose when performing analysis.

Another weakness apparent in some answers, particularly those for the UK version of the examination arose where candidates did not take note of the requirement to **evaluate** the risks and instead produced answers that addressed or mitigated the risks. This meant that candidates did not appropriately demonstrate an understanding of the impact of the risks for the company or the audit and were unable to attain full credit. This appears to be a technique issue and candidates are advised to review model answers to published past Section A questions and to make use of the article on answering risk questions provided by the examining team which can be found at <https://www.accaglobal.com/in/en/student/exam-support-resources/professional-exams-study-resources/p7/technical-articles/exam-tech2.html>

Part (c) required candidates to devise audit procedures in relation to two areas of the financial statements and generally this was answered well by most candidates.

Part (d) of the question covered the interaction of internal and external auditors and candidates often displayed the ability to apply the rules of ISA 610 *Using the Work of Internal Auditors* to the scenario and where attempted were able to attain a good marks in this section of the question.

## Question Two

This question was set at the reporting stage of the audit and performance here was disappointing, with candidates often not distinguishing this from past questions set earlier in the completion and review stage of the cycle. The format was very similar to the September 2018 reporting question.

In part (a), candidates were given a summary of uncorrected misstatements which remained unresolved after the completion review of the audit had taken place. Candidates were asked how they would address these proposed adjustments with the client management. While many candidates were able to take these uncorrected misstatements and explain the matters which should be discussed with the client, a significant portion of candidates instead ignored the correct accounting treatment provided to them and criticised the adjustments the audit firm were proposing. While it is often the case in questions set at the review stage of the audit that the manager will be considering whether an accounting treatment by the client is correct and what evidence is available to support it, the information given to candidates at this point in the cycle was the auditor produced outcome of that review process. Even given the correct financial reporting treatment and journals to correct the errors, a minority of candidates described inappropriate accounting treatments and were unable to tell a loss from a gain. In particular it was concerning that so many candidates believed a provision should be made for a contingent liability which was only possible and for which no reliable estimate could be formed. A second common financial reporting error arose where candidates stated that the use of speculative derivatives should be accounted for as a hedge despite being given the adjustment to correctly treat it as fair value through profit and loss.

Requirement (b) asked candidates to describe the actions to be taken if the adjustments were not made and to justify an appropriate audit opinion. Candidates often ignored the part of the requirement relating to actions to be taken and then gave opinion impacts for the errors individually rather than in aggregate which would be expected where a client fails to correct a number of errors. In this respect it appeared that they were unable to distinguish between the September 2018 requirement which asked for individual impacts on the auditor's report and this requirement which did not. Candidates should always pay attention to the wording of specific questions and not assume they are exactly the same as a previous question.

Part (c) of this question tested ethics and professional issues. Performance here was again mixed. Strong candidates were able to apply their knowledge to the specific scenario in the question and both explain the ethical threats arising and the professional issues the firm was facing. Weaker candidates failed to note that the additional work performed had already taken place or simply stated that for listed companies additional work is not permitted for audit clients. Candidates should be able to distinguish between which additional services are permitted for listed clients and which are not. It is unlikely that an 8-mark requirement can be answered as simply as "the client is listed therefore we cannot perform other services". There was also a worrying inability of some candidates to distinguish between the annual report and the financial statements.

Candidates often ignored the professional issues arising in the question or suggested client management integrity issues as a result of the failure of the audit firm's quality control weaknesses demonstrating an inability to distinguish between the audit firm and the client. A minority of candidates discussed money laundering which was irrelevant to the question.

### Question three

This final question examined other engagements and client acceptance procedures. This question was generally answered well by candidates, many of whom demonstrated commercial awareness and addressed the full requirements with high marks often being achieved. Candidates who focused on historical cost accounting and ethics often did not attain a pass on this question.

Requirement (a) was in two parts. The first part required candidates to explain specific enquiries to be made during a due diligence assignment in order to understand the valuation and operational significance of intangible assets. The focus here was for candidates to demonstrate an ability to understand why the intangible assets were important to the acquiring company and as a result, what the fair value might be. In this respect there was similar focus to that in question 3ai from the September/December 2017 sample questions. Answers to this part of the question were either very strong or very weak. Strong candidates focused on how the intangibles might be impacted by various business-related issues and how that would be reflected in their value to the acquiring company. Weaker candidates produced lists of procedures describing how they would audit intangible assets held under the rules in IAS® 38 *Intangible Assets*. Candidates taking this approach were unable to attain many marks as they did not address the requirement and IAS 38 recognition and measurement criteria are not relevant to the valuation of assets at acquisition which would be addressed using fair value.

The second part of the requirement was to recommend, with reasons, additional information which would help assess other areas of the target company. Here the information required was often identified well but the explanation of why it was needed was often not given. This meant many candidates were often restricted to ½ marks on each item of information requested. Candidates should note that at this level it is the understanding of **why** something is important that will be awarded sufficient marks to attain a pass.

The final part of the question related to the practice management area of engagement acceptance. Here candidates generally scored well where they discussed both the criteria from ISQC1 *Quality Control for Firms that Perform Audits and Reviews of Financial Information and Other Assurance and Related Services Engagements* and the commercial issues which might arise. Candidates who did not perform well on this section of the examination often did not apply those considerations to the specific scenario or focused only on the ethical issues arising without covering the wider issues for the firm.