

Examiner's report

P7 Advanced Audit and Assurance

September 2016

The ACCA logo consists of the letters 'ACCA' in a bold, white, sans-serif font, centered within a solid black square.

General Comments

The examination consisted of two sections. Section A contained one question for 35 marks and one question for 25 marks. Section B contained three questions of 20 marks each, from which candidates had to answer two questions.

In order to pass this exam, candidates are required to apply the principles and rules from their earlier studies to more complex scenarios and demonstrate their ability to handle different situations which may arise in audit and related services. In addition, candidates are expected to develop a broader knowledge of audit services and practice management. Candidates should also keep abreast of current developments and challenges in the field of both auditing and financial reporting to allow them to demonstrate the ability to handle these challenges in the context of auditing financial statements and as areas they may need to brief clients on.

This combination of learned knowledge and its application to complex situations requires candidates to be able to go beyond the topics as covered in text books and be able to react to the scenarios described in the requirement. Study through question practice and following developments in the field through the media, and through IFAC and IAASB will be crucial in taking the learned knowledge from earlier parts of the qualification and converting it into a demonstrable ability to provide audit and advisory services to clients.

P7 also tests candidates' ability to tailor their answer to the context in which the requirement is written. Often the audience of the requirement will dictate the pitch and depth of the answer along with its focus. Failure to take into account such matters will often lead to time pressures in the exam as candidates lose time by detailing knowledge that is not relevant to the requirement. This is particularly noticeable in question 1 which is often set at the planning stage of an audit and is addressed to the senior members of the audit team, meaning an explanation of the audit risk model is not appropriate. Candidates should allow themselves time to focus on the requirement that is set before they begin their answers. It would be useful for candidates to visualise delivering the requirement verbally to the report recipient and therefore imagining how a partner in a firm, already qualified and experienced, would react to listening to the answer.

Specific Comment

Question One

This question followed the pattern of previous examinations and was set at the planning stage of the audit/assurance cycle. The context of the question was a large company looking to expand its international presence through different means.

Part a was a standard audit risk requirement and should have been an area where candidates were able to score strong marks for identifying audit risks from the scenario and describing the effects on the financial statements and elements of audit risk. This part of the question was disappointingly answered by many candidates. There is a tendency for weaker candidates to produce long but irrelevant answers. There is no place in this requirement for describing the audit risk model or discussing ethical issues. If ethical issues were required in question 1 this would be flagged as a separate requirement.

In this scenario the client was not a new client and had pre-existing international revenue streams , demonstrated by the prior year segmental revenue comparatives, therefore discussing detection risk due to a lack of auditor knowledge of the client or inability to audit international revenue was not relevant. The risks in this type of question are flagged up in the scenario and should be addressed using up to date knowledge of financial reporting standards to describe appropriate accounting treatment and highlighting the potential impact of errors on the financial statements. Generally, the direction of the error will be required to score well, simply stating that intangibles may be over or understated will not gain full credit as this does not demonstrate the level of knowledge which is required.

As in previous audit risk questions, there is credit available for calculating and concluding on the materiality of a balance in the financial statements. A majority of candidates are able to correctly select the appropriate benchmark for materiality (eg assessing an asset or liability in the context of total assets rather than on revenue or profits) but frequently answers were presented with materiality based on prior year rather than current year figures. Audit risk continues to be an area that candidates find difficult and particularly it continues to be noted that many candidates fail to engage with the information provided in enough depth, specifically when provided with extracts from financial statements. Candidates are again reminded that in order to provide a full answer in relation to audit risk they should utilise and analyse all the information that is provided.

Candidates were also required to discuss the considerations to be taken into account when assessing whether and how to use internal audit to assist the external auditor. The majority of candidates were able to list the criteria as per ISA 610 Using the Work of Internal Auditors, to assess against and relate that back to the scenario, which was an improvement on the last time this standard was examined.

Finally candidates were required to provide the principal audit procedures to obtain audit evidence in relation to the classification of a joint venture and the measurement of an intangible asset. The majority of candidates performed satisfactorily in this requirement but again many had not read the requirement carefully enough and described tests covering other FS assertions than those required – for example assessing the cost of the joint venture which was not relevant to the classification risk, or failing to take into account that the intangible had been purchased in the prior year so the cost would have been audited at that point so audit procedures should have focussed on confirming the brought forward figure and any adjustments for amortisation or impairment.

There were four professional marks available, and most candidates secured most of these marks by providing an introduction and using headings to create an appropriate structure for their answer. However, presentation was not always good and candidates are reminded to pay attention to determining an appropriate layout for their answer.

Question Two

Question two was a standard format asking candidates to comment on the matters arising and evidence expected to be found in relation to three issues to. Disappointingly the majority of responses to this question demonstrated a significant lack of financial reporting knowledge. Some common issues included candidates incorrectly stating that development costs should be written off and only capitalised when development was complete, and also incorrectly accepting the capitalisation of an internally generated database. This lack of accounting knowledge meant that

candidates struggled to assess the issues and then demonstrate appropriate knowledge in relation to the audit procedures and evidence required.

The final issue related to a defined benefit scheme and financial reporting in this area was particularly lacking and many candidates chose not to attempt this section of the question at all which was disappointing as the main issues in the question dealt with a relatively straightforward issue regarding the accounting for an actuarial loss against profit for the year and the time difference between the actuarial valuation and the year end.

Candidates should also take note of the areas flagged in the question as resolved or satisfactorily assessed already to avoid a lengthy coverage of those areas which is not relevant to the requirement. In this requirement it was stated that “you are satisfied that the expert is independent and is qualified and competent to provide the necessary evidence which is included in the audit working papers” This should signal that the question does not require the issue of the competence of the expert to be addressed.

Section B

Question Three

The question centred on a due diligence engagement and was set prior to tendering and as such tested acceptance issues as well as the wider audit services component of the syllabus.

The question required a discussion of the considerations in deciding whether to tender for the work. In general, this was well answered by a majority of candidates. Stronger candidates were able to relate the acceptance issues to the scenario rather than rely on a rote learned list of acceptance issues. In particular, it was pleasing that many candidates were able to recognise that the firm was being appointed by an existing client to review a takeover target, hence the integrity of the client and “know your client” procedures were not required in this context.

Candidates were also asked why warranties would be an area that due diligence would focus on. This should have been an area where candidates scored well if they demonstrated that warranties represented a significant and uncertain liability which would impact on future cash flows and purchase price. Candidates then had to suggest audit procedures for warranties and generally scored well. Again there were candidates that wrote irrelevant procedures as they failed to appreciate that the financial reporting element was not relevant to this due diligence assignment.

Question Four

Question four focused on practice management and current issues. The first requirement asked about the highly topical area of audit quality and required an explanation of why it is hard to precisely define audit quality and to address why the IAASB thinks that the development of an audit quality framework is in the public interest. This was the least popular of the option questions. In general candidates who had read the article on audit quality written by the examining team were able to make valid points, however most candidates attempting this question did not clearly understand what was required and discussed the expectation gap and ethics instead.

Candidates were further required to assess two issues identified at a quality review of completed audits and asked for actions to take. Candidates here often lost time copying out the scenario and adding little to it other than appreciating that they demonstrated a lack of quality. Stronger

candidates were able to explain how the quality had suffered and describe how to prevent this recurring, along with suggesting widening the review to other audits in the department in question.

Weaker candidates did not appreciate where in the time line the review was set and instead suggested a “hot” review should be carried out which is not possible after the publication of the auditor’s report.

Question Five

This question was the most popular of the option questions and was centred on audit reporting and ethics with a corporate governance slant.

The first part of the question had two elements, an ethics part regarding other services which was generally well answered and a second element which required the implications the governance structure and a potential listing may have on the audit process. Many candidates appeared to interpret this as a requirement to comment on how the governance structure of the client fell below best practice and how to improve that structure and did not address the audit implications at all. This is particularly disappointing given the recent examiners article on the topic and again candidates are reminded to make sure that they read the requirements carefully.

The second part of the question described two issues and candidates were required to discuss the implications for the auditor’s report. Unfortunately many candidates deviated from the requirement and spent time discussing the accounting treatment and audit procedures for an area where there was a limitation on the scope the audit. Candidates also lost time discussing audit procedures on Going Concern, which was flagged as already satisfactorily covered. The understanding of auditor’s reports and their usage continues to be a weak area for many candidates despite it being a core part of the syllabus.

Conclusion

As stated in the conclusion to previous examiner’s report, almost all candidates are able to identify at least some relevant issues to a particular requirement from the scenario, but not all can adequately explain, discuss or describe their points in sufficient depth or detail. Candidates must ensure that they answer the specific requirement which has been set, and focus their answer points on the scenario. Candidates are also reminded that while it is important to have good knowledge of financial reporting, they must be able to link this to the appropriate audit issues that arise in the question scenarios. Candidates are encouraged, as always, to practise past exam questions and to carefully review the model answers and the examiner’s reports that accompany the past exam questions. This is important to gauge the style of question requirement that regularly appears in this paper, and to gain an appreciation of what it means to explain an answer point rather than just identify an answer point