Examiner's report

P7 Advanced Audit and Assurance
June 2016

ACCA

General comments
The examination consisted of two sections; Section A contained two compulsory questions for 35 and 25 marks respectively and Section B contained three questions of 20 marks each, from which candidates had to answer two questions.

Overall performance in the exam was disappointing with it being obvious that many candidates continue to not be properly prepared for this wide-ranging examination and as a result were unable to adequately apply their knowledge to answer the questions set. Too many candidates focused on the minutiae of a point and produced a list of everything they knew about a topic, whether relevant or not, very often missing the wider implications of the issue in hand. There was a clear lack of both auditing and financial reporting knowledge.

Specific areas in candidates' answers and examination technique which contributed to the disappointing pass rate included:

- Writing out or simply restating facts from the question with little or no development,
- Not answering the question as set,
- Quoting accounting standards without applying them,
- Using vague phrases like "perform analytical procedures", "check the relevant documentation", "in accordance with the relevant standard" which do not earn marks unless the point is developed further,
- Poor presentation and layout with a lack of clarity to the explanations provided, and
- Obvious lack of accounting knowledge; an error cannot simultaneously overstate assets and understate profits for example.

Specific Comments

Section A

Question One (35 marks)

The question followed the pattern of previous examinations and was set at the planning stage of the audit and candidates were presented with three requirements, which covered the use of analytical procedures at planning, identifying audit risks and ethics.

Candidates were asked to explain why analytical procedures are a fundamental part of audit planning and this requirement was generally well-answered by the majority of candidates. Good answers were tailored to the specifics of the situation and provided relevant examples.

Candidates were the required to identify audit risks, including through the use of analytical procedures. The best answers demonstrated that a methodical approach had been applied to the information in the scenario, and strong candidates had clearly worked through the information logically, calculating the key ratios and trends from the information provided, identifying the risk factors from the calculations and the remaining information, assessing materiality before going on to explain the risk fully and specifically in terms of how the risk could impact the financial statements. Candidates are reminded that when discussing risk relating to a specific accounting treatment, well explained answers will include an evaluation of the potential impact of the risk factor on the financial statements.

A disappointing number of candidates failed to calculate any ratios or trends from the information supplied and thus provided weak answers and were unable to identify an appropriate number of audit risks for the marks available. Conversely some candidates calculated every trend or ratio possible, which was excessive and demonstrated poor time management; for example there was insufficient information in the question to calculate inventory or trade payable days so these ratios did not add to their answer.

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.

Finally candidates were required to discuss the ethical issues relevant to the audit firm and to recommend any necessary actions. Performance in this area was mixed and it was clear that many candidates did not know the requirements of the IESBA Code of Ethics for Professional Accountants. For example a sizeable number of candidates advised that the audit engagement partner could simultaneously become a non-executive director on the audit committee of the entity under audit and failed to identify that the Code expressly prohibits this due to the extent of the self-review and self-interest threats which would be created. This demonstrates a lack of knowledge of the ethical requirements and a lack of professional judgment. Candidates are reminded that they must revise and be comfortable with the content of the code of ethics. Most candidates were however, able to highlight that there was a potential advocacy and self-review risk from representing the client in a tax enquiry but did not condition this on either grounds of materiality or that the firm had not been previously involved in the client's tax affairs.

There were four professional marks available and most candidates were able to earn the presentation marks by providing a clear introduction and conclusion and using headings to create an appropriate structure for their answer. Many candidates did not articulate their points in a clear or logical order and therefore many missed out on the logical flow and clarity marks.

Question Two (25 marks)

This question combined two familiar formats by asking candidates to comment on the quality of the audit work performed and discuss the quality control, ethical and professional issues raised in part (a) and to comment on the matters arising and evidence expected to be found in relation to a number of financial reporting issues in part (b).

In part (a), there was tendency to re-write statements of fact from the question which scored no marks but stronger candidates discussed the issues and explained why the firm's actions were clearly inappropriate.

Very few candidates were able to discuss the need for materiality to be constantly reviewed throughout the audit in light of changing circumstances. However, most candidates picked up that a significant addition to property, plant and equipment sited at a supplier's premises needed to be physically verified and that reliance on third party evidence for existence was inappropriate in the circumstances. The inventory count had been poorly performed but few candidates developed this to consider where the real audit risks may lie and the need to inform management of the weakness in internal controls and for the auditors to investigate the discrepancies and extend their testing. Improper manager/partner review was highlighted by the majority of candidates but the implications of the partner's cursory review were not always followed through to a logical conclusion.

In relation to the matters to consider, candidates were faced with a situation where the client had encountered a cancelled manufacturing contract. Most candidates scored the materiality marks for both the value of WIP and deferred income. A significant number of candidates discussed how WIP should have been calculated and its composition without realising that this was irrelevant as it needed to be recognised at nil unless a further use for it could be validly identified. Stronger candidates identified that the client may be able to levy a compensation claim for breach of contract.

A worrying number of candidates also believed that writing off a deferred income creditor was a cost rather than a credit to the statement of profit or loss which shows a more fundamental lack of accounting knowledge. Likewise, many candidates confused WIP with R&D contracts and raised irrelevancies such as depreciation.

The question stated that going concern was not an issue yet many candidates discussed this in depth as part of their answer. Candidates must realise that if the question makes a statement of this nature then marks will not be awarded for discussion, regardless of the quality of their answer and are again reminded to read the question scenario carefully.

Audit evidence required was generally well-answered and there were some straightforward marks achieved by a majority of candidates, specifically the needs to obtain the relevant contract, board minutes, the cancellation letter and evidence of funds received. Some candidates were over-reliant on written representations from management which are never as compelling as third-party evidence.

Section B

Question Three

This question focused on forensic audit and the matters to be considered prior to accepting a forensic engagement as well as the investigative procedures that may be employed during such an assignment.

The requirement to consider the professional matters to be considered before accepting the assignment was generally well-answered with most candidates able to set out the usual client acceptance and due diligence steps that would be undertaken. The risk of self-review of the firm's audit work was discussed by numerous candidates despite the question clearing stating that the potential client was not currently an audit client. Strong candidates realised that the events described in relation to cash movements could indicate money laundering and the nature of the assignment could cause a limitation to the scope of work that could be performed.

Candidates were also examined on the investigation procedures required and this requirement was in the most part well answered with the majority of candidates picking up the basics of reviewing the legal documentation involved, checking board minutes for approving new bank accounts and obtaining a listing of all client bank accounts from the bank. Some inappropriate or impractical procedures were suggested, such as interrogation of client staff or reviewing all transactions approved by the financial controller.

Question Four

This question required candidates to provide advice to two clients around the difference between an audit and a limited assurance review and providing non-audit services.

In relation to the differences between audit and limited review, most candidates demonstrated a sound understanding of both and were able to succinctly explain the differences between them including the different audiences for each.

Strong answers were tailored based on the specifics of the scenario and therefore provided relevant advice to the client in question. For example strong answers highlighted that a full audit would be beneficial to the fast-growing client as it would give more credibility to the company, especially as it may be seeking bank finance. Candidates are reminded that at this level answers need to be responsive to the question requirements and should not simply be an exercise in reproducing everything that they know about a topic.

Candidates were also asked to advise a listed audit client, asking for a review of their control systems due to concerns about weaknesses in controls shortly after your firm had signed off the most recent auditor's report.

Few candidates recognised the potential implications on the accuracy of the auditor's report which had been recently issued and that these potential weaknesses could undermine that opinion. Clearly further details were needed to establish if the deficiencies in control would have had any significant impact on those financial statements.

Many candidates simply provided a discussion of the advantages to the client of having a review of the internal control system but failed to appreciate that undertaking such a review for a listed client would be prohibited by the Code, and this again demonstrated that many candidates did not have a good enough understanding of the requirement of the ethical guidelines. In such circumstances opting for a separate team is not an effective safeguard and the review should not be done.

Question Five

This was the least popular question on the paper and had a current issues requirement in relation to the audit of disclosures and also the impact of inadequate disclosures on the auditor's report.

In Part (a) candidates were presented with a discussion requirement in relation to the importance of disclosures to users and auditors and strong candidates were able to provide a thorough discussion in this area, drawing on their knowledge of the recent work conducted by the IAASB. Candidates who were unaware of the recent IAASB project in relation to auditing disclosures struggled to provide any depth to their points and candidates are again advised to take an active interest in current issues affecting the profession.

Part (b) presented candidates with two short scenarios surrounding proposed disclosures in relation to a related party transaction and restructuring and were asked to assess the impact on the completion of the audit and the auditor's report.

Many candidates struggled to adequately discuss the disclosure requirements in line with the relevant accounting standards, demonstrating a lack of relevant accounting knowledge, and many candidates simply stated that the matters should be disclosed rather than addressing the inadequacy of the disclosures as presented.

Answers in relation to the impact on the auditor's report contained significant inconsistencies where candidates concluded that an issue was not material but recommended that the auditor's report and opinion required modification. As in previous examiner's reports candidates are reminded that they must understand the circumstances in which Emphasis of Matter paragraphs would be used. These supplementary paragraphs are not a substitute for a modified opinion and should only be used where there are significant issues that the auditor wants to bring to the attention of the users of the accounts that are already adequately disclosed in the financial statements.

Additionally, it should be noted that just because there was more than one matter that needed referring to in the qualified auditor's report, this does not automatically mean that the opinion should be adverse and candidates are reminded that each issue must be assessed in terms of whether there is a material or pervasive impact on the financial statements.

Conclusion

The overall impression is that the vast majorities of candidates were unprepared for this exam and had not put enough effort into learning many of the basics necessary to pass P7. As stated in the conclusion to the 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 it is important to have good knowledge of financial reporting, and further 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