



# Examiner's report

Audit and Assurance (AA)

December 2018

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 Audit and Assurance exam is offered in both computer-based (CBE) and paper-based formats. The structure is the same in both formats but our model of delivery for the CBE exam means that candidates do not always receive the same set of questions.

- Section A objective test case questions – here we look at the key challenge areas for this section in the exam.
- Section B constructed response questions - here we provide commentary around some of the main themes that have affected candidates' performance in this section of the exam, identifying common knowledge gaps and offering guidance on where exam technique could be improved, including in the use of the CBE functionality in answering these questions.

There were two sections to the examination and all the questions were compulsory. Section A consisted of three OT cases each comprising five OT questions for a total of 30 marks, which covered a broad range of syllabus topics. In Section B candidates were presented with one constructive response question worth 30 marks and two constructive response questions worth 20 marks each; testing the candidates' understanding and application of audit and assurance in more depth.

In order to pass this examination, candidates should ensure they devote adequate time to obtain the required level of knowledge and application. Candidates who do not spend sufficient time practicing questions are unlikely to be successful as the written questions in particular aim to test candidates' application skills.

## **Section A**

It was very pleasing to see that once again almost all candidates attempted all 15 questions, across the three OT cases. Candidates preparing for future sessions are advised to work through the past exams which are available and 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 AA syllabus, rather than attempting to question spot. Section A in the December 2018 examination included, but was not limited to, questions on the following areas:

- Professional ethics and application of ACCA's Code of Ethics and Conduct
- Corporate Governance
- Substantive testing including analytical procedures, revenue, bank and cash and trade payables
- Subsequent events
- Audit finalisation and review
- Auditor's reports

## Sample questions for discussion

The following 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. Candidates are reminded that there will be a mix of application and knowledge questions in Section A and it is imperative that they ensure their knowledge of the International Standards on Auditing (ISAs), relevant financial accounting and important areas of the syllabus such as audit procedures is at an appropriate level.

### Example 1

**Which of the following details should be disclosed in respect of the revaluation of the head office if the auditor is to conclude that the disclosures are adequate?**

- (1) Effective date of the revaluation
- (2) Name of the valuer
- (3) The amount of the revaluation increase
- (4) Carrying amount of the head office under the cost model

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

The correct answer is B.

The effective date of the revaluation, the amount of the revaluation increase and the carrying amount of the head office under the cost model are disclosures required by IAS® 16 Property, Plant and Equipment.

This question demonstrates two key points. Firstly it highlights the importance of disclosures to the audit. Obtaining sufficient appropriate evidence during the audit requires an assessment of the adequacy of disclosures included in the financial statements. Secondly candidates should also note the need for accounting knowledge to answer this question. An understanding of key accounting principles is critical to the audit process therefore candidates must ensure that they are familiar with these. Guidance for candidates regarding the accounting knowledge assumed for this exam is included in the examinable documents list.

### Example 2

All adjustments required by the auditors of X Co have been made to the financial statements with the exception of an adjustment relating to faulty goods held in inventory at the year end. The audit work concluded that the cost of this inventory exceeded its net realisable value by \$2.9m. The directors dispute the audit team's figures and believe that the realisable value of the inventory still exceeds its cost. Profit before tax for the year was \$131.4m.

**Which of the following correctly describes the effect of this matter on the auditor's report?**

- A. Unmodified opinion with no further disclosure

- B. Unmodified opinion with disclosure in an emphasis of matter paragraph
- C. Qualified opinion due to material misstatement
- D. Qualified opinion due to inability to obtain sufficient appropriate audit evidence

The correct answer is A.

The amount of the disputed adjustment is not material, being 2.2% of profit before tax, therefore there is no material misstatement. An unmodified opinion would be issued meaning that options C and D are not correct. The nature of the issue is such that it would not be disclosed in an emphasis of matter paragraph so option B is incorrect. A significant number of candidates chose this option.

Candidates should note the applied nature of this question and the importance of using the information provided in the scenario to come to a conclusion. Candidates must also ensure that they understand that an emphasis of matter paragraph is included in the auditor's report where a matter, appropriately presented or disclosed in the financial statements, is of such importance that it is fundamental to the users' understanding of the financial statements and the auditor wishes to draw attention to that disclosure.

## **Section B**

The constructed response questions in Section B tested candidates understanding of the audit and assurance syllabus:

- 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, and an understanding of both corporate governance and professional ethics.

Questions in this area may present candidates with a scenario-based ethics or corporate governance question. Candidates are generally asked to identify and explain a set number of issues from a given scenario and give relevant recommendations to address the issues identified. An important point to note when making recommendations for ethics and corporate governance questions is that the recommendation must be an action. Often candidates provide objectives rather than actions. 'Hurling Co' from the 'Sample March/June 2017 Questions' is a good scenario based question to practice the skill of explaining ethical issues and making relevant recommendations.

In addition questions in this area can be stand-alone knowledge based, covering areas such as confidentiality or assurance, and do not need to be applied to the scenario provided in the question. In answering knowledge questions it is important to ensure that an adequate level of detail is provided, as often these questions are answered too briefly, almost in a note format. It is

also important to identify the requirement verb, as ‘describe’ or ‘state’ require completely different levels of detail to be provided.

### **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 depend on the ability of students to recall their knowledge in the exam.

As noted in previous Examiner’s Reports 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 (½ marks each), explained (½ marks each) and an auditor’s response to each risk (1 mark each). Typically candidates can be required to identify and explain in the region of six to eight risks and responses.

The scenarios usually contain more issues than are required to be discussed. It is pleasing that candidates planned their time carefully and generally only attempted to list the required number of issues. A point to note however is that there may be risk factors at the beginning of the scenario in the opening paragraph and also in the closing paragraph. Candidates are often missing these. In this session the closing paragraph of a risk question stated that there were purchase cycle deficiencies noted in the prior year. Many candidates failed to spot that this would be an audit risk for the current year. Additionally, it is important that specific issues from the scenario are considered rather than general risks. In this session a question scenario contained a risk relating to the inventory count being held before the year end and the client undertaking a roll forward adjustment. General tests on a year-end inventory count were not awarded credit. Answers needed to focus on auditing the roll forward specifically.

As stressed in previous exam sessions, a significant number of candidates did not explain how each issue could impact on the audit risk and therefore were not awarded the second ½ mark. To explain audit risk candidates MUST state the area of the financial statements 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. A significant minority of candidates stated the risk was ‘under/over stated’ when it was clearly one or the other. They were not awarded credit and this scattergun approach is not recommended.

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. In common with previous sessions, auditor responses were sometimes too weak e.g. “discuss with management”. In addition it was noted that there was a significant increase in responses that focussed on what management should do rather than the auditor, and/or, were inappropriate to the scenario. For example in this session a question included the fact that a new customer had been given improved credit terms. Some candidates discussed

the procedures that should be undertaken to vet the client before offering these terms to ensure the terms were reasonable. This is management's responsibility and is not focussed on what the auditor should do to address the risk arising and so would have gained no marks. 'Blackberry Co' from the 'Sample March/June 2018 Questions' is a good scenario based question on audit risks and responses to practice.

Audit risks and response questions can also be linked with a factual knowledge question. A good example of this is 'Cupid & Co' from the 'Sample September/December 2017 Questions'. In recent sessions candidates have not performed as well as they could have in these knowledge questions. Future candidates are reminded that they must revise all areas of the syllabus and spend adequate time learning knowledge areas in preparation for the exam.

As in all other areas of the syllabus, it is important that the candidate carefully reads the specific requirement of the question. For example, in this session, a question asked for a description of the responsibilities of management and the auditor following ISA 250: 'Consideration of Laws and Regulations in an Audit of Financial Statements.' No credit was awarded for explaining general responsibilities. Answers had to specifically relate to laws and regulations.

As in previous sessions, in this session a number of audit risk questions were combined with a requirement to calculate ratios, these ratios then link into the risk and responses requirement. 'Darjeeling Co' from the 'Sample September/December 2018 Questions' is a good question to practice the skill of calculating ratios and applying these to a risk and response question. Candidates tend to score well in calculating ratios, however a few points to note are as follows:

- Do not calculate more than the required number of ratios as this wastes time
- Do not provide the formula for ratios, as no credit is available.

### **Internal control**

This area of the syllabus requires both an ability to describe and evaluate internal controls techniques and audit tests. It also requires an ability to make appropriate recommendations as well as being able to distinguish between the scope of internal and external audit.

Internal control questions typically require internal control deficiencies to be identified ( $\frac{1}{2}$  marks each), explained ( $\frac{1}{2}$  marks each), a relevant recommendation to address the control (1 mark), and, often a test of control the external auditor would perform to assess whether each of these controls, if implemented, is operating correctly (1 mark). Internal control questions can also include the identification ( $\frac{1}{2}$  marks each) and explanation ( $\frac{1}{2}$  marks each) of key controls as well as tests of controls (1 mark) to assess whether the key controls are operating effectively. Further, answers may be required to be presented in the form of a report to management, in which case a covering letter (2 marks) is required.

Internal control questions often include a knowledge requirement. In common with planning and risk questions, these are relatively straightforward marks and candidates should be attempting to score maximum marks. However it was disappointing to see once again in this session that many candidates failed to score many marks in knowledge requirements. It is imperative that future candidates ensure that they devote adequate time to learning the knowledge areas of the syllabus

as well as practicing this style of question. Good example questions to practice are 'Comet Publishing Co' from the 'Sample September/December 2017 Questions' and 'Raspberry Co' from the 'Sample March/June 2018 Questions'.

Internal controls questions remain a highly examinable area and performance in December 2018 was mixed. The scenarios included in exam questions contain more issues than are required to be discussed. It was pleasing in this session that candidates were generally able to identify (for ½ mark each) the required number of issues from the scenarios. It was however disappointing that some candidates were not able to identify key controls, often identifying the existence of a control where in fact there was a deficiency. As an example, if the scenario states, "supplier statement reconciliations are carried out however reconciling items are not investigated" the fact that the company is reconciling supplier statements is not an effective control and would not be awarded a ½ mark for identification. In this instance the correct conclusion to draw would be that the lack of investigation of reconciling items resulted in a control deficiency.

In common with previous sittings many candidates did not clearly explain the implication of deficiencies identified. It is important that the explanation fully details the impact to the company. As an example, for a deficiency of "purchase orders are not sequentially numbered" a suitable, well explained implication would be "unfulfilled orders cannot be effectively monitored which could result in stock-outs leading to a loss of customer goodwill". Many candidates did not go on to explain the impact on the company.

Most candidates were able to provide good recommendations to address the deficiencies they identified. However some of the recommendations were either poorly described, did not clearly address the specific control deficiencies identified or were impractical suggestions. For example, recommending "production stops during an inventory count" to address the control of movements during a count is inappropriate if the scenario clearly states the company operates 24 hour production. Additionally as with ethics and corporate governance questions, recommendations must be actions rather than just objectives.

'Equestrian Co' from the 'Sample March/June 2017 Questions' and 'Camomile Co' from the 'Sample September/December 2018 Questions' are good internal control deficiencies and recommendations questions to practice.

As in previous sessions it was disappointing that candidates' descriptions of tests of controls that an auditor should perform were often not well explained (e.g. repeated use of the word "check"), did not address the controls identified, or, described substantive audit procedures rather than tests of control. In addition in awarding credit for tests of controls, weak tests such as 'observe' do not score as well as inspection or enquiry type procedures. For some controls it is perfectly acceptable for observation to be used as an audit procedure, such as attendance at an inventory count. However, for testing authorisation controls, the focus should be on inspecting for evidence of authorisation of previous documents rather than observing an individual authorising a document during the audit.

Tests of controls are a key requirement in internal control questions and future candidates must ensure they practice these types of questions in advance of their exam. 'Raspberry Co' from the

'Sample March/June 2018 Questions' is a good question to practice, testing internal control deficiencies and recommendations and key controls and tests of controls.

Candidates should read the AA Technical Articles on 'The Audit of Wages' and 'Using the work of Internal Auditors'.

### **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. Overall performance in this key syllabus area in this exam session was once again disappointing.

The December 2018 exam session contained a number of questions in this syllabus area covering a variety of areas across both the statement of profit or loss and statement of financial position, illustrating that candidates must be prepared to tailor their knowledge of substantive testing to any area of the financial statements. In most cases candidates remain unable to tailor their knowledge of general substantive procedures to the specific issues in the question requirements, with many providing tests of controls rather than substantive procedures, providing incorrect procedures, or concentrating on one type of test e.g. multiple examples of analytical review procedures. In particular care must be taken to address the specifics of the question; where the requirement is to describe substantive procedures to address specific financial statement assertions, such as valuation, any tests provided which do not test this assertion would not score any marks. It was particularly disappointing this session that relatively straightforward audit procedures, such as the audit of a year-end bank reconciliation, were not well answered.

A good example to practice is 'Dashing & Co' from the 'Sample September/December 2017 Questions'.

In addition candidates should read the AA Technical Article 'The Audit of Financial Statement Assertions'.

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. Additionally tests must be sufficiently detailed noting clearly which source document should be used. A significant number of candidates suggest tests such as 'review disclosures' however this would only have scored ½ marks as they did not go on to say 'in accordance with accounting standards'. Also recommending 'obtain a management representation' without explaining what for, e.g. to ensure completeness/reasonableness of a provision, will not generate any marks.

Other good examples of substantive procedures questions to practice are 'Gooseberry Co' from the 'Sample March/June 2018 Questions' and Jasmine Co from the 'Sample September/December 2018 Questions'.

There are many resources available on the ACCA's website which will help you prepare and reviewing these, along with past exam questions, is one of the best ways to help you cover the syllabus and get used to the style of the questions.

### **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 different types of auditor's report, written representations and the final review and report.

Questions in this area of the syllabus tend to be scenario based and may require candidates to describe audit procedures in relation to going concern or subsequent events and one mark is available for each well described procedure. Alternatively they can require an assessment of the impact on the auditor's report due to an unresolved accounting issue.

Performance in auditor's report questions this session continues to be disappointing. Candidates are often required to discuss an accounting issue, assess whether the error is material, consider the type of modification, if any, and lastly to discuss the impact on the auditor's report. Answers must clearly state the opinion to be issued (i.e. unmodified opinion or modified opinion), and if the opinion is to be modified, the type of modified opinion which is appropriate (i.e. qualified opinion, adverse opinion, disclaimer of opinion). Candidates are advised to ensure that they are as knowledgeable on modifications caused by insufficient evidence as they are for material misstatements.

Once again this session many candidates seemed to omit the discussion of the issue, which would score 1 mark. In order to be awarded marks for discussing the issue candidates should not just re-write the issue from the question. Candidates need to explain the effect of the item being incorrectly recorded, for example, if this results in assets/liabilities/profit being over/understated.

Whilst it is pleasing that candidates performed well calculating materiality for auditor's report questions, candidates should note that it is not necessary to show the workings of how materiality is calculated as there is only ½ mark available for this.

Unless stated otherwise in the question requirement, candidates should only include the type of modification required if the company does not adjust for the issue in the financial statements. Weaker candidates continue to discuss what the report will look like if the error is adjusted for and if it is not. This is not an efficient use of time as only responses which answer the question will generate marks. It was also disappointing that a number of candidates did not understand the appropriate use of an emphasis of matter paragraph.

Auditor's reports are a core area of the syllabus and knowledge of the ISAs in this area is imperative. Good questions to practice are 'Airsoft Co' from the 'Sample March/June 2017 Questions', 'Gooseberry Co' from the 'Sample March/June 2018 Questions' and Jasmine Co from the 'Sample September/December 2018 Questions'.

In addition candidates should read the AA Technical Article 'The Auditor's Report'.

## **Exam technique**

Good exam technique is vital for success in AA. It was pleasing to see many candidates followed the instructions in audit risk and internal control questions and structured their answer in columns. Not only does this make it easier to mark, it makes it easier for a candidate to review their answer and ensure they have covered all of the relevant areas, for example, it is clearer to see if a test of control has been omitted. A minority of candidates are writing out the questions in their answer booklet, this is not necessary as it is not marked and it wastes time.

Additionally, it was pleasing that where a question asked for a specific number of issues to be addressed, such as risk and internal control questions, most candidates attempted to identify the required number demonstrating appropriate exam technique and time management.

Once again it was disappointing to see that some question requirements were not attempted. This tended to be in knowledge areas and substantive testing questions. This could have been down to a lack of knowledge or exam preparation.

Candidates need to ensure that their answers relate to the scenario given. In questions requiring a description of substantive procedures these were often too generic. Candidates need to particularly ensure that substantive procedures and tests of control are clearly described as to exactly 'how' the procedure should be performed. Also an adequate number of procedures must be provided; a five mark question should have at least five well described procedures to maximise the candidate's mark.

## **Word processing technique**

Candidates sitting CBE questions used the word processing tools available adequately. It was pleasing to see that the length and depth of many CBE answers has continued to significantly expand on previous sessions. However please note that when answering into a pre-formatted table, providing bullet points is acceptable, however answers must be sufficiently detailed and not 'note like' in order to maximise marks.

Very occasionally, the typed words in some candidates' answers were difficult to understand as the words were misspelt. Candidates are reminded that there is no automatic spelling checker tool available and to try and manage their time appropriately to allow for a review of their answers before submission. Also when reviewing answers look out for omission of key words, for example, the omission of the word 'not' can completely change an answer.

There are resources on ACCA's website giving more guidance on how to use the word processing tools. A video introducing the main functionality and how to make best use of these in AA can be accessed via the website.

## **Guidance and Learning Support resources to help you succeed in your exam**

Preparing for the AA exam can appear challenging but there are many resources available to help you. You should refer to these throughout your studies.

You should make sure you have made use of all of the resources found [under technical articles for AA](#) – these include technical articles, study support videos and exam technique resources – all developed with you in mind.

Additionally [Examiner's Reports](#) are available after each exam session. These are a valuable tool for understanding the exam, avoiding common pitfalls and developing exam technique. Work through the AA resource 'Examiner's approach' and also 'A guide to using the examiner's reports' if you are sitting the exam for the first time or 'A guide to reflection' if you are retaking your exam. Both of these interactive tools can be found under the [technical articles page](#) for AA. These have been developed to sit alongside the self-study guide and the [retake guide](#) respectively, and provide you with further pointers for using the examiner's reports for previous sittings.

It is essential to practise as many exam standard questions as you can in the lead up to your exam, this is critical for AA as 70% of the marks are written. We strongly recommend that you use an up to date question and answer bank from one of our [Approved Content Providers](#) but if this is not possible then work through the most [recent past exams](#) on our website. However, please note if you are using the past exams that these are not updated for syllabus changes or changes to the exam format since September 2016 and so should be used with caution – so check the [latest syllabus and study guide for changes](#).