Examiner's report

Advanced Audit and Assurance (AAA)
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

Overall, candidates appeared to be better prepared for the examination and demonstrated improved exam technique compared to recent examination diets. There was less indication of time pressure as a result of poor technique and in general, candidates provided answers which addressed the requirements rather than simply giving a discussion of irrelevant points. However, the ability to apply that knowledge appropriately rather than simply state a learnt point is still not demonstrated by a majority of candidates. Those candidates who did demonstrate such skills were able to score well and secure a clear pass mark.

The exam is in two sections; Section A consisted of a 50-mark compulsory question, and Section B which consisted of two compulsory questions of 25-marks each. The Section A question tested candidates' ability to tackle the planning stage of an audit alongside audit acceptance considerations. Question 2 was focused on audit completion including reporting and going concern assessment, with Question 3 covering money laundering, ethics and professional issues.

The syllabus for the AAA examination builds upon both the earlier audit examinations and the Strategic Business Reporting (SBR) exam, by introducing more complex topics and covering the basic topics from different angles to test that candidates can apply their knowledge to some of the challenge's auditors will face in their professional life. Candidates can find the examinable documents for the exam here and should note that the accounting standards listed on the SBR examinable documents for the session are also examinable in AAA.

While the exam requires knowledge of the underlying syllabus, the majority of marks derive from the application and understanding of that knowledge rather than the knowledge itself. It is therefore important that candidates don't simply learn the content of the syllabus but instead they learn how to use and apply it. It is the application of the auditing and financial reporting standards that will attract marks. A focus on application means candidates will be presented with various scenarios to which they should apply their knowledge or a discussion where they demonstrate an understanding of the underlying issues arising.

In the AAA exam it is important that candidates manage their time properly and avoid spending time on points which do not receive credit. There are some areas, which are discussed next, where many candidates could save time in the examination. Firstly, with regard to the professional marks, candidates should follow the guidance given in the discussion of the Section A question given below. This is an area where candidates often lose time writing too much for the marks. Further, candidates should also avoid repeating large sections of information from the question, explaining theories or providing definitions. Candidates should also be selective in their calculation of ratios rather than producing pages of calculations which are not then referred to or discussed in their answers.

A more effective way for candidates to use their time in the exam would be to study the wording of the requirement carefully and note what it is that the examiner is asking of them. Questions candidates should ask themselves before writing an answer include: *which stage of the audit is the question set at? Is it before or after the year end? Is the question asking for answers to be applied to the client or to the firm? what type of engagement is it?* Time invested here will allow candidates to develop a more precise answer and therefore attract more marks than rushing into a question and writing pages of irrelevant or sometimes impossible answers. It is also important to allow the mark allocation for a question to guide the length of the answer given. This is something that is learnt best from past question practice and using the marking scheme provided with published past examinations to understand ***how*** many points should be made to secure a strong mark. The published past examinations for AAA can be found here. Candidates should note however, that the model answers provided with this examinations are longer than would be expected in exam conditions and are at a level of depth designed to be used as a learning aid.

Specific Comments

Question One

This question was a compulsory 50-mark case study style question comprising five parts. Requirements (a) – (c) focused on audit planning for an existing audit client and requirements (d) and (e) related to a non-audit client and acceptance procedures. In addition, there were four professional marks available.

One professional mark is awarded for each of; *a suitable heading, a brief introduction, a structured answer and clarity of explanations*. All candidates should be capable of scoring a minimum of three professional marks and should note that in this examination a brief introduction is all that is required and time should not be spent writing a full-page introduction or lengthy conclusion. For a structured answer, simple headed paragraphs are the easiest way to score these marks. Candidates need not worry about spending time underlining or numbering headings as long as it is clear to which question/sub-question the points relate. For clarity marks the markers will consider whether they understood what the candidate was trying to convey and whether the discussion addressed the requirement. This is not the same as a requirement to write in perfect English and candidates are not penalised for poor spelling and grammar if the marker can understand the point being made.

Requirement (a), for eight marks, asked candidates to evaluate the business risks arising from the scenario in the question which focused on an existing audit client which operated a number of sports and leisure centres. This requirement is historically one where candidates achieve a strong pass and this trend continued in the December 2018 exam. It was pleasing to see that most candidates focused on the risks arising from the scenario and avoided speculative or generic risks. There were two marks available for each business risk and it should be noted that factors from the scenario could be described in a number of different ways in order to attract credit for that risk. The key here is that candidates look for a variety of indicators within the scenario on which to base their evaluation. Some candidates could improve their time management and marks here by avoiding repeating the same risk from lots of different angles – failure of the expansion strategy for example could be discussed in terms of a stock exchange listing, new gyms opened, diversification of services offered or acquisition plans however there are only two marks available for a risk connected to this indicator so discussing all of those in depth meant candidates didn't' have the time to describe sufficient risks. Candidates that remained focused here often achieved full marks. Those that focused on solely expansion and health and safety compliance from several different angles tended to only score four out of the eight available marks.

Although this requirement provided candidates with a strong start to the examination, there were a significant number of candidates who demonstrated a lack of understanding over the role of non-executive directors in relation to the scenario. Non-executive directors (NEDs) are typically brought onto a board for their knowledge and skill in a particular field. One such director in the question had previously been the chairman of a rival company. This director brought industry specific business experience to the board and this practice is typical in the business world, however many candidates appeared to think that he would leak information back to the company where he had previously held a non-executive position, out of loyalty. Very few candidates identified the real weaknesses in the board, such as a lack of financial expertise amongst the NEDs and a lack of an audit committee. It is often the case in exam answers that candidates do not appear to understand the difference between executive directors/management and NEDs/those charged with governance (TCWG) and as a result use the terms management and TCWG interchangeably.

Part (b), for 18 marks required candidates to evaluate the risks of material misstatements (RoMM) arising from the scenario. This was generally well attempted by the majority of candidates and covered financial reporting issues such as revenue recognition, the treatment of government grants, related party transactions and loan finance, alongside control risks such as the lack of independence of the internal audit department and systems changes. Where RoMMs covered financial reporting issues, candidates who followed the process of calculating materiality, stating the relevant accounting rule and applying that to the scenario to show where the risk arose and the impact on the financial statements were able to score full marks on risks covered. Some common issues in candidate answers included:

- Interpreting the question as all audit risks rather than RoMM which meant time was lost discussing detection risks which could not attain marks,
- Lack of knowledge of basic double entry and the subsequent impact on the financial statements
- Discussing speculative risks not present in the scenario such as brands and intangible assets
- Giving audit procedures for each risk which is not required and therefore attains no credit.

It should be noted that when the question asks for RoMM, it does not require the definition of risks, theory behind audit or the audit approach to address the risks. Candidates who have studied past exams will have noted that in planning questions where audit procedures are required this has been asked for as a separate requirement and only over specific areas of the scenario.

Requirement (c) for six marks, required candidates to state principal audit procedures to be used in the audit of a grant received from the government. Candidates generally described the audit procedures well, with a source and a purpose and were able to focus on confirming the details of the grant to the formal agreement and consider the output from the system to confirm that conditions were being met. In this case the majority of the candidates were able to attain a pass on this requirement. Two common mistakes were noted; the first was the inclusion of irrelevant or ineffective tests such as reviewing board minutes for approval of the grant and written representations from management that the company had received the grant. Candidates who followed the guidance on audit procedures provided in the recent technical article should have been well prepared for this type of requirement and it should be noted that for six marks candidates should expect to give six well described procedures.

Part (d) for eight marks, introduced another client into the scenario and covered specific acceptance considerations and overall the marks here were disappointing. When considering audit acceptance, candidates are expected to cover competence and capability, ethical requirements and client integrity as specified in ISQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements* as well as the commercial aspects of the decision. The requirement specifically asked candidates to evaluate these considerations with respect to an engagement to provide either an audit or a limited assurance review for an existing non-audit client. While many candidates were able to state some of the areas to be considered most did not apply these to the scenario at all and made generic comments that did not demonstrate the skills required to evaluate the situation. In this exam it is unlikely that simply stating learnt knowledge without application will be sufficient to pass any question. For example for client integrity and customer due diligence considerations marks were available for stating that as an existing client this would already have been performed but may need updated not for stating the company should perform it prior to acceptance. It was also disappointing that while most candidates know the names of ethical threats the majority of candidates still do not sufficiently justify how they arise or the implication, both of which are needed to score the marks at this level. In this case, a self-review threat arose with respect to payroll work done at the client. The firm also provided tax advice to the owner but not the company. Typical answers that candidates wrote which would not attain any credit included:

- *Providing other services gives rise to a self-review threat* - this statement shows no appreciation of which services give rise to this threat nor any implication
- *Providing personal tax services to the owner is a self-review threat* – this is incorrect, there is generally no financial statement/audit impact arising from the owner's personal tax (if there were it would be given in the scenario – see discussion of question 3b later)
- *Providing payroll services gives rise to self-review* – this answer is better but still does not demonstrate that candidates know that the threat arises because the payroll figure is a material figure in the financial statements and would therefore be subject to audit by the firm

Often candidates who were able to link the self-review to the audit of the payroll figure would not describe the implication of the threat to enable them to score a full mark. Simply saying that self-review means the auditor is not objective does not demonstrate understanding of the concept – how that lack of objectivity manifests is also required. Detailed guidance on how to discuss ethical threats for the AAA examination is provided in a recent technical article which can be found here.

Candidates often missed the conflict of interest between the first client in the question and the second client and the time pressure highlighted by the deadline in the scenario.

Finally requirement (e) for six marks asked candidates to discuss whether an audit or limited assurance engagement would have identified a fraud in a minor revenue stream at the second client in previous years. Candidates who discussed materiality, sampling and the different level of testing that the two alternatives would provide tended to score well. A common mistake from candidates was to discuss forensic audits to investigate fraud which was not something asked for in the requirement. Many candidates appeared to incorrectly think that a limited review of financial statements as an alternative to an audit is the same as a review of prospective financial information.

Question Two

This was a 25-mark question covering the going concern assessment for a non-listed client and was set at the completion stage of the audit.

Requirement (a) for ten marks asked candidates to evaluate matters which cast doubt on a client's ability to continue as a going concern (GC). Candidates were directed to analytical review of a cash flow forecast to aid in their evaluation and those who used the quantitative and discursive parts of the scenario to describe the GC risk indicators with an explanation of how that impacted on the company's future tended to score high marks on this question. Candidates who merely calculated ratios and stated the direction of movement or simply stated that an increase in the receivables collection period showed going concern issues attained very few marks. It is important candidates demonstrate their knowledge of **how** each matter gives rise to an issue for trading as a going concern. For example a fuller explanation would be that the increase in the receivables collection period may mean that there are irrecoverable debts which should be written off, increasing losses further, or that slow collection would decrease liquidity and therefore put pressure on the ability of the company to make payments as they fell due. A technique candidates could employ here would be to ask themselves **why** as they get to the end of a sentence, allowing them to add a second sentence demonstrating their understanding. A minority of candidates appeared to lack focus on the question requirement and answered this as a RoMM discussion, covering risks of material misstatements in the forecast rather than relating the scenario to the GC issues required.

Part (b) for nine marks requested an explanation of the audit evidence which would be needed with respect to the forecast and candidates scored best when they remembered this was future/prospective information, not historical, and where they related it specifically to the information given. For example, candidates who looked for specific assumptions in the information provided and devised sources of evidence to support each of those assumptions were able to attain far more marks than candidates who simply said evaluate the assumptions used by management in preparing the forecast. It is important that candidates appreciate that no two questions are the same and that the information given in the question should always be used to drive their answer.

Finally part (c) for six marks required candidates to explain why the directors may wish to exclude disclosures relating to going concern uncertainties in the notes to the financial statements and the possible implications on the auditor's report. Candidates were generally able to identify the reasons for non-disclosure but performed very poorly on the auditor's report implications. Many candidates wrongly stated that the directors omitting a required disclosure would not constitute a material misstatement. Many therefore went on to conclude that the opinion would be unmodified but that going concern disclosures would be made in the auditor's report instead of in the notes to the financial statements. This is not the case and candidates should ensure they are familiar with the reporting requirements in ISA 570 Going Concern. Some candidates suggested including such disclosures in the Key Audit Matters section or to include an Emphasis of Matter paragraph both of which would be inappropriate.

Question Three

Question three was a 25-mark question centred on money laundering and ethics at an existing audit client.

Requirement (a)(i) for four marks asked for a discussion of policies and procedures a firm should have in place in relation to an anti-money laundering programme. Most candidates were able to score full marks here. Candidates who did not score well either simply listed points with no discussion or confused the audit firm with the client and discussed controls over cash sales or places where the client could implement policies.

The second requirement (a)(ii), was for six marks and asked candidates to evaluate whether there were indicators of money laundering by the client or its staff. The majority of answers to this requirement were disappointing. Most candidates were able to correctly identify the indicators at the client which might suggest money laundering activities but made no attempt at explaining or evaluating those indicators. Simply stating sales are cash based or there is an off-shore bank account does not demonstrate an understanding of why these things are an indicator. Candidates would do well to add the word **because** at the end of such sentences to force them to explain why something is a red flag. For example "*the company sales are 75% cash based. This is a potential indicator of money laundering* ***because*** *cash based sales are harder to trace*." An even stronger answer would then relate this back to the stages of money laundering, giving a "**So What?**" to their answer. "*This means that additional cash can be introduced alongside genuine sales. This would represent the placement stage of money laundering*". Another mistake candidates often made in this part of the question was to discuss the risk of employee fraud/theft of the cash which was not required.

Part (c) was a 15-mark requirement to discuss the ethical and professional issues arising at the client. Candidates tended to perform poorly in this requirement. This was partly down to candidates not leaving enough time to properly address the requirement and partly because candidates are still not demonstrating the understanding of ethical issues or how to describe them sufficiently to attain marks. Candidates here also often showed a lack of detailed knowledge of the ethical guidance that would help them to properly analyse the issues in the question. In addition to the points on describing ethics made above in relation to question one, common mistakes made by candidates were to assume that invoicing the company for the tax work done on behalf of the directors was disallowed (rather than identifying that if the company was paying for his tax work, this should be considered director's remuneration and not part of the audit fee for disclosure and possible personal tax reasons) or stating that a trivial benefit provided to the auditors was not permitted which again is not the case, trivial hospitality benefits are permitted but should be approved by the firm. One of the most concerning points that was made in many answers was to correctly tie in the risk of money laundering at the client and the need to report this to the firm's money laundering reporting officer while avoiding tipping off but then to follow that with the suggestion that the firm resign from the client immediately and inform TCWG of the money laundering – so effectively then tipping off the client.

Conclusion

Overall candidates appeared better prepared for this examination in terms of knowledge of the syllabus but many candidates do not take the time to address the requirements given or to apply, rather than state, knowledge. The ACCA website provides technical articles from the examination team which aims to demonstrate how candidates can maximise their marks in questions. These should be used in conjunction with practicing the past questions in order to supplement the knowledge of the syllabus when preparing for the exam. Candidates should remember however, that every question is different and candidates reproducing an answer to a previous similar question will not be sufficient to pass the exam. Candidates should also be aware that as auditing and financial reporting standards change, past exam answers on the ACCA website will not be updated to reflect the current examinable documents.