Examiner's report

Advanced Audit and Assurance (AAA)
September 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. Section A was a 50-mark case study placing the candidate in the position of planning an audit while section B comprised two 25-mark questions, one of which was set at the completion stage of the audit. All three questions were compulsory.

The purpose of the AAA examination is to enable candidates to demonstrate the skills required of a professional auditor. These skills are tested in a range of contexts where a candidate is expected to apply, rather than simply state knowledge. In order to demonstrate the skill required, candidates are expected to be able to understand the underlying concepts and apply them to specific scenarios set in different stages of the audit cycle or non-audit assignments. They also need to appreciate the differences between scenarios from one session to the next. A rote-learnt answer to past questions, or facts from a study text is unlikely to be sufficient to pass this examination.

Candidates are expected to have an understanding of the content of Audit and Assurance (AA) and a strong understanding of financial reporting topics. All the standards examinable in the Strategic Business Reporting (SBR) examination are also examinable in AAA. Without an underlying knowledge of how to account for items in the financial statements it is not possible to identify the audit risks arising from these or the specific assertions the audit procedures need to address.

The syllabus and study guide set out the high level of understanding required for this examination by using verbs such as analyse, critically assess, apply knowledge and evaluate. Candidates should be able to synthesise and evaluate material. Simply listing knowledge without explaining its relevance or purpose will not be sufficient to pass the exam. This is particularly important with responses relating to procedures, where the purpose of the procedure must be given, and ethics, where knowing the name of an ethical threat will not be awarded credit in its own right, rather identifying the specific way in which the threat arises in a given scenario and the implication in that specific case is required to attain credit.

Generally, the performance in the September 2019 examination mirrors that in previous AAA examinations. Candidates find the application of knowledge difficult and often merely list points without applying their knowledge to the scenario or fail to take note of the stage or type of audit or assurance engagement in the question resulting in generic or irrelevant answers.

The most common weaknesses in underlying knowledge that are evident at each session are:

- A lack of basic double entry skills with candidates often confusing assets with liabilities or assuming that if assets are overstated profit must be understated
- A lack of underlying knowledge of financial reporting
- An inability to make an appropriate materiality judgement
- Failure to understand the impact of issues on the auditor's report

Further details of these are given below in the question commentary.

Specific comments

Section A

Question One
This question was set at the planning stage of the audit for an existing client. The scenario revolved around a long established group of companies audited by the same audit firm. The group was undergoing restructuring with several proposed changes to group structure some of which would not occur until after the year end.

There are four professional marks available in Question One. These are awarded as follows:

- 1 mark for a suitable heading
- 1 mark for an introduction – this need be no more than a short introductory paragraph
- 1 mark for the structure of the answer, including the use of headings and paragraphs
- 1 mark for the clarity of the candidate's explanation

Candidates should refer to published answers for section A questions to understand how to present a suitable heading.

Part (a) required candidates to describe audit risks arising in relation to the group audit and was similar to the requirements seen in many past questions. Candidates generally appeared well prepared for this question and were able to identify several audit risks and evaluate them in such a way as to obtain a pass mark. When evaluating risks, candidates are advised to always bring in specific references to the scenario, give the details of the accounting treatment required where possible and the financial statement implications arising as a result of the audit risk. Candidates should ensure they provide an appropriate calculation of materiality and a conclusion as to whether an item is material or not material. Both of these are required for credit to be awarded.

Common issues arising on this requirement were as follows:

- Candidates giving rote-learnt risks with no application to the scenario, for example stating that this was a new client (it was an existing client) or that a significant risk to a listed company is management bias without referring to any specific bias drivers from the scenario (e.g. to prove the success of a restructuring strategy, to maximise the sales price for a subsidiary being disposed of) or demonstrating where the bias might impact on the financial statements (e.g. the incorrect recognition of the grant received in profit or the under amortisation of a three-year licence). Candidates must relate the audit risks to the information provided which will be different in every examination.

- Candidates describing audit risks that were highly unlikely to be a genuine risk – for example many candidates thought there was an audit risk that an acquisition planned for next year might be included in this year's consolidation in error or that a disposal the group were hoping to make post year end required the company to entirely remove the assets and liabilities from the consolidated financial statements and replace it with the profit on disposal.

- Candidates not fully understanding the basic concepts of control or influence in the context of group accounts, for example stating that a 50% shareholding means a company must be a subsidiary. While a shareholding over 50% might be indicative that control exists or a shareholding in the region 20-50% may indicate influence exists, the principles underlying financial reporting are based on substance not just strict percentage rules.

Part (b) was a four-mark requirement regarding additional information required to plan the audit of a disposal. This was well answered by candidates who appreciated that this did not relate to the final audit procedures but information that could be requested in advance.

Part (c) required audit procedures regarding a government grant and the classification of an investment in a joint venture. Generally, this requirement was well answered although common errors with the requirement regarding the joint venture were to cover a wider scope than classification or instead to give procedures for a totally different transaction from the scenario (e.g. a common incorrect answer was to list procedures relating to the audit of the PPE investment in a different group company). These errors arose from a lack of attention to the specific requirement.

Part (d) was a ten-mark ethics requirement and candidates' answers tended to be weak here. Many candidates simply listed the names of ethical threats without any application to the specific scenario. This is disappointing given the specific guidance published on the ACCA website as to what is required in terms of description for credit to be awarded in this area. Here candidates demonstrated that they had learned a list of threats but failed to demonstrate that they understood them or knew how they applied to a question. This was particularly apparent with regard to the request that an audit partner take a temporary position on the audit committee. Many candidates said this was a self-interest threat however they described it as arising because the partner would be paid a fee rather than because the partner would then be involved in the choice of audit firm and setting of the audit fee.

Candidates also demonstrated insufficient detailed knowledge of the IESBA International Code of Ethics for Professional Accountants. Candidates often incorrectly stated that referral fees are not permitted, but recommended the use of a separate team to devise and test controls over revenue as an internal audit assignment which, for a listed company, is prohibited as revenues are a material component of the financial statements.

Section B

Question Two

Question Two was set at the completion stage of an audit and proved difficult for many candidates. In part (a) three property-related issues were described for an audit client of the firm and candidates were required to analyse the matters to be considered (e.g. materiality, accounting treatments permitted, how that applied to the client in question, potential errors) and the evidence that would be expected on file in order to be able to conclude on the issues.

Topics covered were a sale and leaseback, where control had passed to the lessor, an investment property and the reversal of an impairment relating to a property being used by the company.

Very few candidates appeared to understand the concept of control underpinning the sale and lease back – often candidates performed the appropriate test of considering the proportion of the life of the property that would be leased back but then incorrectly concluded that renting the property for one fifth of its life was effectively still owning the property. What was more concerning was that a significant minority of candidates were still discussing the concept of operating and finance leases and applying outdated accounting standards to a topic that has been examinable under IFRS16 *Leases* for several sessions.

The investment property requirement was handled better and many candidates were able to describe the option of holding the property at fair value with gains and losses being taken to the statement of profit and loss. Many candidates though then went on to say the property should then be depreciated or that it wasn't an investment property despite not being owner occupied or used within the business.

With regards to the impairment reversal, candidate performance was mixed. Many candidates realised that the reversal would be restricted and were able to obtain credit even if they didn't appreciate that the reversal was not restricted to the previous impairment charge but should be restricted to the written down value the asset would have had, had it not been impaired in the first place. Beyond that however many candidates suggested that the excess value of that amount could be recognised within Other Comprehensive Income which is not the case unless the company is using a revaluation model rather than a cost model for properties.

Many candidates were able to identify relevant audit procedures for the above accounting issues. In some instances this was the case even where they did not appear to fully understand the accounting issues themselves.

Part (b) required candidates to consider the effect of the misstatements in the investment property and the reversal of the impairment on the auditor's report. Here candidates often assessed the significance of the misstatement by reference to the entire asset value rather than the error amount, resulting in the conclusion that an immaterial misstatement would result in an adverse opinion. It was also common here that where a candidate calculated that the error was immaterial, they would go on to conclude that it was in fact material. It is vital that candidates appreciate the concept of materiality and are able to correctly apply it at this level.

As noted in previous sessions, there was a significant minority of candidates who concluded that the immaterial misstatement should be disclosed in an emphasis of matter paragraph, again demonstrating a lack of understanding of the concept of materiality and when the use of an emphasis of matter paragraph is appropriate.

Question Three

This question was set in the context of a non-audit assignment for a non-audit client. Candidates were asked to consider acceptance criteria for an investigative forensic appointment in response to a fraud at a manufacturing company. The scenario detailed a fraud where inventory was stolen, and the assignment was to quantify the fraud for an insurance claim. Most candidates demonstrated the ability to apply acceptance criteria with reference to the specific question. A minority of candidates discussed irrelevant considerations that appeared to have been learnt from a previous question set in a similar context. Whilst the criteria for assessment were similar, some of those points were not relevant in this case and candidates wasted time in the exam discussing issues that would only be relevant to an existing audit client.

Part (b)(i) of this question asked candidates to suggest the steps or procedures that could be used to quantify the fraud and answers here tended to be either very good or very poor. Good answers methodically went through the process of identifying the fictitious customer, extracting data on cancelled orders and matching that to missing inventory through an inventory count. Weaker candidates were those who approached this by listing pre-learned procedures or without taking in to account the assignment and scenario. Such candidates often suggested tests that were based on samples as would be relevant to an audit rather than trying to definitively quantify the loss. Other mistakes made here were focusing on sale price rather than cost or trying to trace the stolen inventory with reference to sales invoices despite the goods stolen not being invoiced. There was evidence of candidates listing procedures from a previous forensic investigation question that were not relevant to the scenario described and therefore could not be awarded credit.

Part (b)(ii) required candidates to identify and explain the deficiencies in controls that allowed the fraud to occur and recommend improvements. Candidates were often able to score maximum credit in this area by giving detailed explanations. Weaker candidates tended to identify the deficiency from the scenario but were unable to describe how it resulted in the fraud or made unspecific recommendations e.g. improve segregation of duties or someone should approve cancellations – to obtain full credit more detail was required such as who should approve a process or how duties should be segregated.

Part (c) required a discussion of factors making fraud hard to identify and was well answered by candidates that completed it.