Examiner's report

P7Advanced Audit and Assurance
September 2015

General Comments
The examination consisted of two sections. Section A contained 2 questions totaling 60 marks. Question 1 was worth 35 marks and question 2 was worth 25 marks. Section B contained three questions of 20 marks each, from which candidates had to answer two questions

In general, candidates managed their time well in the exam with the majority of submitted scripts being complete or substantially complete. Time management and presentation were generally well evidenced however some weaker candidates attempted to present answers in a columnar format. This typically scores fewer marks as these answers more often than not lack the depth and application that is needed at this level. In addition, at this level candidates are expected to be able to apply their knowledge to specific scenarios in the question rather than simply state a point.

A good understanding of both audit and financial reporting issues is required in order to perform well in this exam so candidates who are able to discuss both these aspects demonstrate more effective application and analytical skills. Many of the weaker scripts indicated that candidates had limited knowledge of auditing principles and that candidates struggled to appropriately apply knowledge to the question scenarios.

A common reason for poor marks in this exam from well prepared students is failing to read and remain focused on the requirement in order to provide specific relevant answers. Of particular importance is the attention to the time-frame and the stage in the audit cycle and to the type of assignment being examined.

A number of common issues arose in candidates' answers that contributed to the disappointing pass rate:
- Writing too little for the marks available
- Failing to develop points beyond simple identification of facts given in the question. Answers often lacked the detailed evaluation and assessment of the issues identified that is required at this level.
- Lack of knowledge of certain fundamental syllabus areas such as audit reports.
- Lack of basic accounting knowledge – for example not understanding how transactions are recorded and whether accounting errors would lead to the overstatement or understatement of balances and transactions.

Specific Comment

Section A

Question One
This question followed the pattern of previous examinations and was set at the planning stage of the audit/assurance cycle and covered risks, audit procedures and ethical issues.

Candidates were required to provide an analysis of business risks for a diversified group operating in a variety of sectors. In addition there was an acquisition of a foreign subsidiary. Performance on this section of the paper was generally strong and this reflects candidate performance in previous sittings where business risk has been examined. Candidates here were generally able to identify the risks flagged in the scenario and describe them in terms of the effect on the company itself. A small minority of candidates gave audit risks rather than business risks in this section but this was less of an issue than in previous sittings.

Candidates were required to provide four risks of material misstatement within the group audit. In general this was well attempted although some candidates failed to calculate and conclude on the materiality of these risks which is a key part of demonstrating that risks of MATERIAL misstatement are being identified. These marks have been available in all recent sittings of the exam and it is disappointing that candidates are not prepared to support their answers with these key calculations. A significant number of candidates listed the internally generated brand in this section of the answer despite it being correctly omitted from the statement of financial position.

The best answers demonstrated that a methodical approach had been applied to the information in the scenario, and the better candidates had clearly worked through the information logically, identifying the risk factors, before going on to explain them fully and specifically in terms of how the risk could impact the financial statements. Candidates are reminded that when discussing risks of material misstatement 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, Strong candidates, as well as providing detailed analysis and explanation of the risks, also attempted to prioritise the various risks identified thus demonstrating appropriate judgment and an understanding that the audit partner would want to know about the most significant risks first. Candidates are again reminded that it is those risks that could result in a material misstatement in the financial statements, which need to be identified and addressed.

Candidates were then further required to detail audit procedures with regard to a provision in the financial statements. Candidates were generally able to produce strong answers to this part of the requirement. A minority of candidates attempted to list procedures covering a range of financial reporting issues which were not required and showed a lack of attention to the specific requirement in the question.

The requirement to consider the ethical issues relating to the provision of other services and contingent fees was generally well answered.

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 set prior to acceptance of a potential audit client and covered a combination of acceptance issues and required money laundering knowledge.

Candidates were required to identify and explain matters to be considered in deciding whether to accept an audit appointment. This was generally well answered and most candidates were able to make their response specific to the scenario. There is still temptation for candidates to revert to producing a generic list of rote learnt points without taking into account that some of these may not be relevant, for example in this question the outgoing auditors had already responded to the firms request for information so it could be inferred that the potential client's permission to contact them had been obtained already. While it is important that candidates understand all the different steps that are needed prior to acceptance, candidates must be prepared to tailor that understanding to demonstrate appropriate judgement of what is needed in the circumstances.

The second part of the question required candidates to explain the “know your client” procedures which would be required prior to accepting the audit and was well answered.

The latter part of the question required candidates to describe audit planning matters relevant to an initial engagement and was disappointingly answered given that a very similar requirement was set in the previous examination. The most common issue here was candidates failing to relate the requirement to an initial engagement or to the client as described in the scenario and instead list general planning points that would be relevant to all audits. Candidates are again reminded that they must answer the question that is presented and it is expected that the answer points provided are specific and relevant to the details of the scenario.

The final part of the question asked for audit procedures regarding a cash payment with potential money laundering implications and again these were generally well laid out and explained. Some candidates however outlined procedures required to audit a property which again demonstrated poor attention to the requirement set.

Section B

Question Three

Question 3 was the most popular choice of the optional questions, and was answered by a significant number of candidates.

Candidates were required to provide a description of the purpose of a due diligence assignment and to demonstrate an understanding of the purpose of due diligence by providing a comparison with a statutory audit of financial statements. The majority of candidates attempting this part of the question scored well demonstrating sound knowledge of this area of the syllabus.

The remainder of the question focused on the work that may be performed during a due diligence assignment and specifically around the valuation of specific assets and liabilities within a target company. The question here asked for further information that may be required and enquiries that would be made in order to provide assurance on such items. Candidates produced the strongest answers with respect to the valuation of a purchased licence albeit often focusing on initial recording rather than current values/impairment. The valuation of an internally generated database proved harder as many candidates quoted the financial reporting rules and concluded it should not be presented within the financial statements. This was often despite having previously described the purpose of due diligence as a method of identifying assets and liabilities not included in the financial statements which nevertheless would form part of the fair values at acquisition. Candidates would benefit from reviewing the question as a whole in order to consider how the different sections and requirements fit together. More effective planning, prior to writing, would allow candidates to demonstrate a better understanding of these connections.

The final item related to a contingent liability that was presented in the target company's financial statements. Answers to this were of mixed quality but it was disappointing how many candidates again lost sight of the assignment being one of due diligence and made comments regarding the financial statements disclosure requirement. Again candidates are reminded that more effective use of reading and planning time would allow a clearer understanding of what is being asked for and that time should be spent ensuring that answers are tailored to the specifics of the question.

Question Four

This question caused problems for many candidates which was disappointing given that an element of the question examined knowledge rather than application of the syllabus. Candidates were required to discuss two methods that audit firms can utilise to limit their exposure to litigation claims, and to evaluate those methods and comment on the implication for the profession. Many candidates failed to identify the three components of the requirement and did not take their answers beyond the description of two methods. This again emphasises the importance of careful reading of the requirement and candidates should again ensure that they read the question carefully and consider and plan the points that should be covered to score the marks available before writing. It was also clear that many candidates were not guided by the mark allocation for this part of the question, candidates should bear the mark allocation in mind, and use it to determine how long to spend in answering each part of the question.

This question also asked candidates to describe the auditor's responsibility in relation to a fraud discovered at a client. Stronger candidates were able to identify the auditor's responsibility to detect fraud and were able to discuss the possible implications taking into account the immateriality of the fraud. Some candidates misunderstood the requirement and produced answers as to how they would approach an assignment to investigate the fraud.

The second part of the requirement examined an understanding of the tort of negligence as applied to the scenario and again answers were mixed. Those candidates who had understood the requirement and who could identify and apply the tests of, duty of care, breach of duty, and consequential loss to the parties in the question scored well. Those who did not appear to understand the requirement often talked instead about reissuing the company financial statements.

Question Five

This question examined audit reporting, group audits and quality reviews. Candidates were required to critically appraise a draft audit report. This approach to an audit report question has been seen many times in the past and answers were generally good in this area. A minority of candidates however incorrectly spent time discussing the accounting treatment for contingent liabilities rather than contingent consideration in an acquisition context. This often led to the conclusion that there was no requirement to qualify the audit report therefore the shortcomings of the report were overlooked.

The second part of this question examined the impact of a qualification in a subsidiary audit report on the group audit report. In this case, stronger candidates identified that the limitation in scope as described in the question was immaterial and was unlikely to have an impact on the group audit report in isolation. Weaker candidates spent time considering the assessment of extent of reliance on component auditors or suggested that the error be corrected in the group financial statements reflecting inattention to the scenario which was clear that lack of evidence was the issue rather than an error to be adjusted. A significant proportion of candidates still propose adding other matter or emphasis of matter paragraphs into the audit report to draw attention to immaterial items that need not be disclosed.

Finally candidates were asked to describe quality control procedures which would be required for this listed client prior to the audit report being issued. This was particularly poorly answered with many candidates listing either general characteristics of quality control across the audit cycle or describing the general completion process tasks such as analytical review and disclosure check lists. The requirement to focus on the quality control review required for listed clients and in particular this client, with a modified audit report was often missed or only mentioned briefly as perform a "hot" review. Some candidates suggested a cold review which would be performed after not prior to the issuance of the audit report.

Conclusion

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 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 papers. 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.