Examiner's report

Advanced Audit and Assurance (AAA)
September 2018

ACCA

General Comments

The examination consisted of two sections. Section A contained one compulsory question for 50 marks and Section B contained two compulsory questions of 25 marks each. The format differed from previous sessions with the change of format being introduced with the revised syllabus. Candidates who had read the examiner's approach document on the ACCA website and the published specimen exam should have been prepared for this change in structure. The examination itself was very similar to the specimen exam in its presentation of audit planning, audit adjustments for reporting considerations and the assurance work on forecast financial information. Any candidate who had spent time understanding the way the answers in the specimen exam related to the examiner's requirements should have been well prepared for the examination.

Candidates should note that to prepare for examinations at the Strategic Professional Level they will have to have a good understanding of syllabus content and the ability to apply their knowledge to different scenarios, appreciating the differences between scenarios from one session to the next. Many candidates appeared to produce answers to past questions in the examination rather than address the scenario presented. For the AAA examination candidates are expected to demonstrate the ability to apply the underlying financial reporting and audit knowledge from their previous studies alongside the new technical areas covered in the AAA syllabus. Candidates differentiate themselves by their ability to adapt to different scenarios. While past exam questions are an invaluable source for demonstrating how candidates can assess situations and apply their knowledge it must be remembered that financial reporting, the business environment and auditing guidelines are not static so past answers may not be applicable in the same way several years after that question was set.

Candidates should also note that in addition to text books and past exams, there are a series of technical and exam technique articles on the ACCA website with very specific guidance from the examination team on how a candidate can demonstrate sufficient detail in their answers to score maximum credit. It is unlikely that candidates will be able to score good marks without providing a level of detail which demonstrates they understand the points they are referring to.

Specific Comments

Question One

Question one was a 50-mark case study style question with four requirements. It was set at the planning stage for an audit in a similar style to the specimen exam and to question one under the old P7 examination structure. The client was a large international listed distribution company which had a new foreign subsidiary acquisition in the year. Consistent with previous sessions four professional marks were available.

The first requirement was to produce an analysis of audit risks using analytical review of financials and other information provided on specific issues arising during the year. The format was the same as in the specimen exam and the requirement was worth 24 marks. Of these, up to five marks were available for the calculations forming part of the analytical review and up to four marks could be obtained for relevant materiality calculations and conclusions. The majority of marks were available for the evaluation of significant audit risks, which is consistent with past requirements of this type.

This requirement was generally well attempted by the majority of candidates who calculated relevant ratios, discussed the risks arising from unexpected trends and relationships, and then analysed the risks arising from the specific issues described in the question. Using this approach and providing an evaluation containing the level of detail provided in the article https://www.accaglobal.com/uk/en/student/exam-support-resources/professional-exams-study-resources/p7/technical-articles/exam-tech2.html, well prepared candidates were able to identify the specific risks from the information provided and score a clear pass on this part of the question. The model answers provided to recent past audit risk questions will illustrate how to structure answers to achieve maximum credit on this sort of requirement. It was pleasing to note that very few candidates spent time describing the theory of audit risk which is not required and should not be included in an answer unless the examiner has asked for it.

Despite the good attempt made on this part of the examination there were some common exam technique issues which resulted in difficulties for candidates in terms of attaining marks and managing their time. The first of these was the approach taken by some candidates to the analytical review. Common issues arising from the analytical review were:

- Calculating too many ratios and trends which were not then mentioned in the main body of the candidate's answer and were a waste of effort - candidates are expected to demonstrate the auditing skill of knowing which items are unlikely to give rise to an audit risk – for example an immaterial area of the statement of financial position that hasn't moved much since the previous year and is not referred to in the question scenario is less likely to contain an audit risk. Candidates should consider how many risks and calculations are likely to be needed to score full marks rather than calculate 30+ ratio/trends which they then do not have time to discuss. A few key ratios along the lines of those seen in the answers to past questions are most likely to direct candidates on where to focus.

- Calculating ratios and then not referring to them – an analytical review is not simply calculating ratios. The ability to calculate ratios is examined within earlier parts of the qualification. It is what the results show that is the applied skill in this area and candidates who do not use the results of their calculations to draw conclusions and identify risks will not be able to attain credit.

- Not calculating any ratios – ignoring the requirement to perform an analytical review will restrict the risks identified from the scenario and hence make scoring maximum credit very difficult. This was most apparent in scripts from candidates sitting the UK version of the examination where many scored very few marks on this section of the question.

Another common mistake candidates made on this requirement was to spend a lot of time discussing speculative risks which generally do not obtain credit. The fact that a company is multinational with many subsidiaries does not automatically result in a key audit risk regarding the inability of the company to know how to perform a consolidation, or to account for foreign currency. The fact that this is not a new client and the audit engagement partner did not raise any concerns in this regard past should be taken as a sign that these are things are not key issues. Candidates should instead focus on the details given in the scenario that the engagement partner thought relevant to highlight. In this case, the acquisition of a new subsidiary and the risks arising from what is a significant non-routine transaction, the significant spend during the year on research and development which has been capitalised, and the fact that management does not believe there is any impairment of assets despite falling revenues. Recent past question answers illustrate the sort of risks which are considered relevant to the accompanying scenarios. Speculative risks do not attract credit in the examination and it is surprising that candidates chose to evaluate such risks when there were so many specific risks contained within the scenario. This session it was disappointing how many candidates opened with speculative risks such as failure to cancel intercompany balances, failure to account for day-to-day foreign currency transactions, and the control risk arising from international subsidiaries. Candidates would score better if they were to prioritise risks in their planning and to focus on the ones described in detail by the examiner in the scenario rather than reproducing a rote learnt list of general points which do not demonstrate any application of knowledge to the scenario itself. A related mistake made by candidates was to discuss operating segments and EPS disclosures despite the requirement stating that these should not be considered. This has been the case in several sessions where the examiner has requested candidates do not consider presentation risks.

Other commonly seen technical errors arose in relation to provisions where candidates would assume that redundancies early in the financial year would give rise to a year-end redundancy provision. Post year-end redundancies are those which may give rise to a provision. Similarly, candidates often thought that, because automation was introduced during the year, it was likely that a similar strategy would exist in the future therefore provisions should be made for more redundancies "just in case". Such reasoning demonstrates a lack of comprehension of the fundamental concept of a liability and the requirement for a constructive obligation to exist before a provision can be made.

For up–to-date examples of how **audit risk** is examined and the sort of points the examiner expects to be raised from a given scenario, candidates should refer to the September 2018 examination, the specimen exam, the March/June 2018 and the September/December 2016 published sample questions and answers. Candidates should note however that these are illustrative and that not every risk covered in those examples will be relevant to future questions on audit risk. A helpful exercise might be to map back the areas covered in the model answers to the indicators in the specific scenario to better understand how the examiner's answers reflect the specific areas of the information provided. In particular the September 2018 exam should provide an illustration of the type and volume of calculations that the examiner considered appropriate based on the marks available and the information provided.

In addition to these issues, otherwise capable candidates failed to attain a strong mark on this section of the examination by failing to address the requirement. Particularly common in the UK and Irish versions of the examination was candidates discussing issues in terms of business risk or audit procedures, which were not asked for, and not actually evaluating the audit risk. Often candidates referred to accounting standards by number but made no attempt to describe the accounting treatment or to apply it to the scenario to determine the risks of material misstatement or would simply say that areas might be misstated without reference to the balance or direction of misstatement. The above referenced article on risks illustrates the level of detail required for full marks when describing a risk and can be supplemented by the following article https://www.accaglobal.com/uk/en/student/exam-support-resources/professional-exams-study-resources/p7/technical-articles/exam-tech3.html which describes how to maximise marks when discussing risks arising from accounting issues.

The second requirement for six marks asked candidates to provide audit procedures on the goodwill figure at acquisition for the subsidiary purchased in the year. Where candidates focused on the specific requirement and addressed the acquisition figure they generally scored full marks or close to full marks. Some candidates limited their marks here by discussing impairment reviews and disclosures instead.

The third requirement was a 10-mark requirement asking candidates to review and evaluate specific parts of the component auditor's strategy. This was the area of Question one which caused candidates the most difficulty. The requirement asked candidates to specifically focus **only** on the two issues mentioned in isolation and that all other considerations were satisfactory. Despite this a majority of candidates wrote answers describing the assessment of independence and competence of the component auditor.

The first part of the strategy related to the intention to audit using a controls-based strategy but without testing controls this year as prior year results were good. Those that did go so far as to appraise the component strategy often thought that a controls-based approach was not permitted, and substantive testing should be performed in all places. Very few candidates appeared to appreciate that controls may be tested on a three-year cycle rather than every year.

The second area to be considered differed in the UK/IRL version of the examination from the INT examination. INT candidates were asked to appraise the components strategy of obtaining direct assistance from internal audit. Reponses here were mixed, with many candidates simply stating that internal auditors are not competent or independent and therefore could not be used. Given that candidates should be expecting to earn five marks on this requirement it should have been clear that more than once sentence was required to pass this part of the question.

UK and IRL candidates were told that the component auditor had performed a pension valuation for the new subsidiary. Many appeared to think this was a signal that the figure could be relied upon rather than considering the materiality of the balance and the fact that external auditors are not permitted to provide valuation services for listed clients where the amounts would be material to the financial statements.

The final requirement related to the client's request for the auditor to be involved in choosing KPIs for inclusion in the client's integrated report and to provide assurance on the report. Many candidates realised that there were ethical issues arising from this but did not explain specifically how they would arise or what the implication would be. Candidates should be prepared to give such detail in order to demonstrate understanding rather than simply list without explanation every possible threat to independence. Guidance on how to phrase such answer points can be found at https://www.accaglobal.com/uk/en/student/exam-support-resources/professional-exams-study-resources/p7/technical-articles/exam-tech1.html and such an approach is consistent with the way ethical threats are marked in the Audit and Assurance paper therefore candidates should be familiar with the level of detail required.

Candidates should note that the presentation marks are awarded for a suitable heading, a brief introduction, a structured answer and clarity of explanations. All candidates should be scoring a minimum of three professional marks and should note that in this examination a brief introduction need be no more than a single sentence and time should not be spent writing a full-page introduction. For a structured answer, headed paragraphs are the easiest way to score these marks. 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 as long as the marker can understand the point being made.

Question Two

This was a 25-mark question comprising two parts. Part (a) was worth 17 marks and was presented as a list of proposed audit adjustments and was very similar to the reporting requirement in the specimen exam. In this case, the requirement was more straightforward and asked for the matters to discuss with management and the impact on the audit opinion should management fail to adjust the errors. Candidates often did not remain focused on the requirement and detailed effects elsewhere in the auditor's report and the other actions they would take if management did not agree to amend the errors. In this question the correct accounting treatment was described for leases in addition to presenting the correctly calculated audit adjustments.

Candidates often scored well in this requirement if they explained why the proposed treatments by the directors were not compliant with accounting standards (requirement for consistency in accounting policies, the requirement not to net off assets and liabilities and the relevant costs for calculating asset fair value less costs to sell in an impairment review). Common mistakes made in this question arose where candidates determined the directors were right and the auditors wrong or where they proposed to include a qualified audit opinion for an immaterial misstatement. Candidates should not assume that every issue in a reporting question will lead to a qualified opinion. An immaterial misstatement does not give rise to a modification to the opinion and conversely modifications cannot be avoided for material errors by including an emphasis of matter paragraph instead.

Candidates should also note that when presenting audit opinions, it is not sufficient to say the opinion would be modified as this could mean any of four possibilities. Candidates should state the type of modification proposed eg *qualified on the basis of material misstatement* to score the mark. Simply writing qualified will not attract full marks as this could refer to either a material misstatement or an inability to obtain sufficient evidence. Similarly, when justifying the severity of a modified opinion candidates should justify whether something is pervasive or simply material to obtain the full mark. Simply stating something is not pervasive will only receive ½ a mark. This is consistent with the way audit reporting is marked in the Audit and Assurance paper and candidates should be used to this approach. Candidates who struggle with the format of auditor's reports should refer to the following article which describes the key components and how to make a decision as to whether an item is pervasive or not. https://www.accaglobal.com/uk/en/student/exam-support-resources/professional-exams-study-resources/p7/technical-articles/exam-tech5.html

Another weakness in answers provided here was to use out-of-date accounting standards to produce an answer. The examinable documents for Strategic Business Reporting are also examinable for this examination. While the majority of answers correctly applied IFRS 16 *Leases* to the question (the relevant parts of the standard were described within the scenario) a significant portion of the UK and IRL candidates continued to reference outdated treatment based on the definitions of operating and finance leases. It is important to note that the examinable versions of standards are those listed in the examinable documents area of the ACCA website and often this is in advance of the implementation in some jurisdictions. The examinable documents for this examination can be found at https://www.accaglobal.com/uk/en/student/exam-support-resources/professional-exams-study-resources/p7/examinable-documents.html

Part (b) was less well answered. Candidates were presented with two ethical issues for eight marks and often were unable to describe how the threats arose. In particular, other than the common mistake of not adequately explaining the threats to objectivity that were present specific to the scenario, candidates appeared unable to differentiate between a loan from any audit client and a loan on normal commercial terms from a client that happened to be a financial institution. Similarly, candidates did not appear to be able to differentiate between the safeguards appropriate for a non-listed client and one which was. This was particularly the case on the UK and IRL exams where local regulations prohibit the provision of the service in question as it would form a material component of the financial statements.

Question Three

Question three was a 25-mark question made up of two distinct scenarios. Part (a) was very similar to Question three in the specimen exam and asked for the considerations for an audit firm when deciding whether it could provide assurance on prospective financial information. Candidates could score well on this requirement if they had prepared by reviewing similar past requirements, the specimen exam or if they were aware of the content of ISAE 3400 *The Examination of Prospective Financial Information*. The main weaknesses in answers on this requirement was where candidates did not tailor their answer to an existing client and hence lost time giving detail on customer due diligence, or where candidates did not give detail on the ethical threats arising. This is a common area where candidates lose marks. Another area of this requirement where candidates limited their capacity to score well was by focusing on post-acceptance issues such as the production of an engagement letter rather than the pre-acceptance decision issues.

Candidates were then asked to describe procedures to be performed on the profit forecast. The majority of candidates scored well on this section and a large number of answers provided a much clearer description of audit procedures than that seen in previous sessions. A minority of candidates made bland comments about agreeing opening balances and loan covenants which were not relevant to the statement of profit or loss. For candidates who struggle with this area, the following article https://www.accaglobal.com/uk/en/student/exam-support-resources/professional-exams-study-resources/p7/technical-articles/exam-tech4.html provides guidance on how to word procedures for the purposes of this examination.

The final requirement for INT candidates was a 10-mark quality control question which was similar to past exams where candidates are required to describe quality control failings. While few candidates scored full marks here the answers provided were generally good if candidates had allocated sufficient time to this requirement.

For the UK and IRL exams, this requirement was an insolvency question, the first part of which asked for the definitions and implications of fraudulent and wrongful / reckless trading. This section was disappointingly answered with the majority of candidates discussing either the concept of fraud or money laundering. The second part of the question was the application of those definitions to a client that was clearly wrongful / reckless trading and potentially fraudulent trading. A very small minority appeared to have any knowledge of this part of the syllabus.