Audit and Assurance (AA) March/June 2024 Examiner's report

The examining team share their observations from the marking process to highlight strengths and weaknesses in candidates' performance, and to offer constructive advice for those sitting the exam in the future.

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General comments

The Audit and Assurance (AA) exam is offered in computer-based (CBE) format. The model of delivery for the CBE means that candidates do not always receive the same set of questions. In this report, 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.

- Section A objective test (OT) case questions – here we look at the key 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 are two sections to the examination and all the questions are compulsory. Section A consists of three OT cases each comprising five OT questions for a total of 30 marks, which cover a broad range of syllabus topics. In Section B, candidates are 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.

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 practising questions are unlikely to be successful as the written questions in particular aim to test candidates' application skills.

Section A

Example of a case scenario

It is 1 July 20X5. Signal Co is an oil exploration company. You are employed by Spring & Co and you are finalising the audit of Signal Co for the year ended 31 March 20X5. The financial statements show profit before tax of $98m and total assets of $650m.

The key dates in relation to the audit are as follows:

7 July 20X5	Audit fieldwork to be completed
15 July 20X5	Financial statements approved by the directors
17 July 20X5	Auditor's report to be signed
30 July 20X5	Financial statements will be issued to the shareholders
5 September 20X5	Annual General Meeting will be held

Fire at oil refinery
Management informed you that a fire, on 30 April 20X5, at one of Signal Co's main oil refineries destroyed assets with a carrying amount of $40m. As a result of the fire, there are ongoing production issues at the refinery.

Other subsequent events
The following subsequent events were discovered during the audit fieldwork:

- **Customer liquidation:** A customer owing $930,000 to Signal Co at the year end went into liquidation on 15 April 20X5. The liquidator has indicated that it is unlikely that any payment of the debt will be made.
- **Dividend:** On 30 April 20X5, Signal Co declared a significant final dividend to shareholders relating to the year ended 31 March 20X5.

Question one

ISA 560 *Subsequent Events* requires that auditors should perform audit procedures to identify subsequent events. The period covered by this review for Signal Co commenced on 1 April 20X5.

Which of the following dates is the end of the period covered by the subsequent events review?

A. 7 July 20X5
B. 15 July 20X5
C. 17 July 20X5
D. 30 July 20X5

The correct answer is **C**, 17 July 20X5 as this is the date the auditor's report is due to be signed. Once the auditor's report has been signed, the auditor has no further responsibility to identify subsequent events. However, they must take action if they become aware of an event after the auditor's report is signed which results in a material misstatement of the financial statement and would therefore require the audit opinion to be modified.

Question two

Which of the following audit procedures should be carried out in respect of the fire at the oil refinery?

(1) Enquire whether Signal Co has included a provision in the 20X5 financial statements for the replacement of the assets and confirm the basis of the calculations

(2) Review the cash flow forecast for the year ending 31 March 20X6 and assess the impact of replacing the assets

(3) Discuss with the directors the ongoing impact on Signal Co's production activities and their assessment of when production will recommence

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

The correct answer is **D**. The fire is a non-adjusting event as it occurred, and caused damage, after the year end. There is also no obligation created that would necessitate recognition of a provision, even if the fire had occurred before the year end. The cost of replacing assets and the impact on production could cast doubt on the appropriateness of the use of the going concern basis of accounting, so (2) and (3) are valid procedures to perform.

Question three

Which of the following options correctly classifies the subsequent events identified during the audit work in line with IAS 10 *Events After the Reporting Period*?

	Customer liquidation	**Dividend**
Option 1	Adjusting	Non-adjusting with disclosure
Option 2	Non-adjusting with disclosure	Non-adjusting no disclosure
Option 3	Adjusting	Adjusting
Option 4	Non-adjusting no disclosure	Adjusting

A. Option 1
B. Option 2
C. Option 3
D. Option 4

The correct answer is **A**. The discovery of the liquidation gives evidence about a condition at the year end (the recoverability of the debt) and is therefore an adjusting event. The declaration of a dividend after the year end only creates an obligation at that point and so is a non-adjusting event. As it is significant and of importance to the users, it is material and should be disclosed.

Question four

The auditor's report was signed on the planned date and an unmodified opinion was issued. It is now 19 August 20X5 and the directors have informed you that an oil tanker belonging to the company was involved in an accident five days earlier. This caused an oil leak and has the potential to cause environmental damage which will cost a significant amount of money to clean up.

If the directors do not reissue the financial statements, which of the following actions should the auditor INITIALLY take?

A. Adjust the financial statements to reflect the impact of the event
B. Take steps to prevent reliance on the existing auditor's report
C. Contact the shareholders to notify them of the event
D. Resign as auditor

The correct answer is **B**. As the auditor's report has been issued to the shareholders but the audit opinion contained within is now incorrect, the auditor must take action to prevent reliance being placed on the existing report.

A is incorrect as it is not the role of the auditor to prepare, or make adjustments to, the financial statements. C is incorrect as it is not the auditor's responsibility to inform the shareholders of the event. D is incorrect as resignation would not be an initial action to take.

Question five

After consideration, the directors have decided to reissue the financial statements which the audit engagement partner has reviewed and confirmed as appropriate.

Which of the following correctly identifies how this will impact the revised auditor's report?

A. Unmodified opinion with no additional disclosure
B. Unmodified opinion with disclosure in an emphasis of matter paragraph
C. Unmodified opinion with disclosure in the key audit matters section
D. Unmodified opinion with disclosure in the other information section

The correct answer is **B**. As the audit engagement partner has confirmed the changes to the financial statements are appropriate, an unmodified opinion should be given. For the audit engagement partner to come to this conclusion, adequate disclosure of the need to reissue the financial statements must also have been made by the directors. An emphasis of matter paragraph will be included in the auditor's report to draw the users' attention to the disclosure made by management.

Section B

Green Co

This 30-mark question is based on Green Co, which sells plants, garden equipment and garden furniture to wholesale and retail customers. This question tests candidates' knowledge of audit risks and responses, consideration of laws and regulations, substantive procedures for additions to property, plant and equipment and quality management deficiencies and recommendations.

Requirement (a) – 16 marks

Describe EIGHT audit risks and explain the auditor's response to each risk in planning the audit of Green Co.

(16 marks)

Marks are awarded for identification of audit risks (½ mark each), explanation of audit risks (½ mark each) and an appropriate auditor's response to each risk (1 mark each). With a scenario-based requirement such as this good exam technique is critical.

The scenario will typically contain more than the number of risks required, so it is important that candidates plan their time carefully and only attempt to list the required number of points. The first step is to identify the factors which will give rise to an audit risk. This information can be found in the scenario. All of the information in the scenario should be read carefully, including the opening paragraph as this may include information relevant to the identification of audit risks. When undertaking this read through it would be good exam technique to use the highlight function as this provides a visual aid for quickly spotting audit risks. Having looked at the whole scenario and highlighted relevant points candidates should pick their eight strongest points, re-read them from the scenario, drafting their answer as they go along.

Candidates often use the copy and paste function when drafting their answers for the identification of the risk. However, care should be taken to ensure that the risk is correctly identified. Simply stating a fact from the scenario is not always the same as identifying an audit risk. Financial accounting knowledge is also important as audit risks will often focus on the accounting treatment used in the financial statements. In Green Co, accounting issues which give rise to audit risks include those relating to property plant and equipment, intangible assets, provisions and inventory. Hence a strong knowledge of relevant accounting standards is required to fully understand the audit risk and therefore a relevant auditor response.

The risks least identified by candidates related to Aidan White the CEO planning to sell his shares in the company and the movement between the gross profit and operating profit margins. Candidates should expect a range of topic areas within an audit risk scenario, some of which may be more challenging than others.

When tackling audit risk questions which include ratios whether pre-calculated or not, the calculations should be considered when identifying the risks. The scenario stated the receivables collection period for 20X4 was 40 days and the forecast for 20X5 was 67 days, in the case of this significant movement along with the information in the scenario about the absence of the credit controller, this identifies a possible risk of overvaluation of receivables. Some candidates incorrectly used this information to generate two audit risks, both relating to overstated receivables with similar auditor responses. Candidates should note that if two pieces of information result in the same audit risk then credit is only available once as the information should be used in conjunction.

Having identified the risk factor, the next step is to explain the risk. To do this, candidates need to state the specific area of the financial statements impacted with an assertion (for example cut-off, valuation etc.), or, a reference to over/under/misstated, or, a reference to inherent/control/detection risk. 'Misstated' will only be awarded if it is clear the balance could be either over or understated. For example, if the risk should have been described in terms of an understated balance, then no credit would be awarded if candidates referred to a misstated balance. Candidates cannot hedge their bets by providing both options.

The explanation of the risk must also clearly state the specific area of the financial statements impacted. For example, in respect of the issue relating to the refurbishment of the retail stores, only noting non-current assets or assets could be overstated would not be awarded credit. An appropriate explanation in this instance would be that property, plant and equipment could be overstated.

In addition, some risk explanations were inappropriate. For example, candidates focused their explanation of the advertising expenditure risk, on how the intangible asset should be amortised. Instead, this risk actually related to an overstatement of intangible assets as the expenditure should have been expensed. In addition, for the new loan risk, some candidates incorrectly believed that needing a loan meant that a going concern risk arises, this is not the case and so no credit was awarded. Candidates must take the time to carefully read the scenario, noting any relevant information, to ensure that they correctly understand and describe the audit risks arising.

Having identified and explained the risk, the next step is to provide the auditor's response. Responses must be practical within the context of the scenario and care should be taken to ensure the response is one an auditor would make and not a management response. In this session candidates in particular provided management responses for the audit risk relating to the increased receivables collection period, such as 'recruit a replacement credit controller'. Candidates are advised to take a moment to read their responses and ensure that what they are recommending will help the auditor to form a conclusion on the identified audit risk.

In this session some candidates struggled to produce valid explanations and auditor responses for the risk relating to the sale of the shares by the CEO. Candidates incorrectly stated that the potential sale of shares would result in a going concern risk, rather than one of manipulation of the financial statements. They then recommended going concern procedures as the auditor response. Additionally, candidates struggled with their response for the risk relating to the movement in the margins. Simply suggesting reviewing the breakdown of the expense categories, without comparing to something, such as the prior year, would not generate valid audit evidence or gain credit.

Additionally, a significant minority of candidates gave general statements of the required accounting treatment. For example, for the inventory risk, it was common to see 'perform net realisable value (NRV) testing' rather than how the auditor would test whether the cost of the damaged inventory was above or below NRV. This general statement approach indicates a lack of practice in tackling different risks and responses questions from previous exams.

Candidates often suggest 'increased professional scepticism' for a whole range of audit risks, and whilst valid, on its own it is not a suitable auditor's response for 1 mark. This is because increasing scepticism does not, on its own, help the auditor to gain suitable audit evidence over the identified audit risk. For the sale of shares by the CEO risk, simply stating 'increase professional scepticism' will only gain ½ mark. To gain the full 1 mark, candidates need to focus on additional testing of judgemental areas as well as assigning more experienced staff to the audit. This was the only risk which gained credit for 'increased professional scepticism'; it was not a valid response for any of the other audit risks.

Auditor responses do not have to be a detailed procedure, rather it is an approach the audit team will take. Care must be taken however, to ensure that the approach suggested actually addresses the risk identified and contains sufficient detail. A response of 'discuss with management' will not gain any credit as candidates need to be very clear exactly what they are asking management about. Where further documentary evidence is available to the auditor candidates need to refer to this to gain the available 1 mark per response. Also, consideration should be given to the reliability of audit evidence gained; for example, evidence gained via confirmation from a third party, such as lawyers, will be more reliable than verbal assertions from management.

Future candidates are advised that audit risk is and will continue to be an important element in the syllabus and must be understood. Candidates must ensure that they include adequate question practice as part of their revision on this key topic.

Good questions to practice from the published sample questions include Knight Electronics Co September/December 2023, Lapis Co March/June 2023, Magpie Co September/December 2022, Esk Co March/June 2022, Peach Co September/December 2021, Corley Appliances Co March/June 2021, Scarlet Co March/June 2020, Hart Co September/December 2020, Harlem Co September/December 2019 and Peony Co March/June 2019.

Requirement (b) – 4 marks

Explain the responsibility of Teal & Co under ISA 250 *Consideration of Laws and Regulations in an Audit of Financial Statements*.

(4 marks)

This is a relatively straightforward knowledge requirement which has been tested in previous exam sessions. Knowledge requirements such as this often have an opening statement, sometimes referenced to an ISA, and this is useful for setting the scene and providing clarification on the aim of the question requirement. Also, when reviewing knowledge requirements, it is important to identify whether an understanding of the scenario is required in order to attempt the question. Where the knowledge requirement is not linked to the scenario a note is included confirming this.

It is especially important that candidates understand exactly what the question is asking, especially for knowledge questions, where candidates should be aiming to score full marks. Question requirements such as this demonstrate the importance of having a detailed understanding of the ISAs, and in this case ISA 250 *Consideration of Laws and Regulations in an Audit of Financial Statements*. For a four-mark knowledge requirement, candidates should aim to provide four well-explained points. Care should be taken when reading the requirement to ensure that answer points focus on the right issues. For example, a significant number of candidates incorrectly focused their answers on the company or management's responsibilities. This is despite the requirement only relating to the responsibilities of auditors. Candidates must take the time to carefully read and identify key words in the requirement, in order to ensure their answer is relevant.

Generally, candidates did not perform well on this requirement. Many provided answers focused on the auditors' responsibility in relation to fraud and error, preconditions for an audit or an auditors' overall obligations to provide a true and fair opinion; none of these points were awarded credit. It was disappointing to note that few candidates understand the auditor's direct and indirect responsibilities under ISA 250. Where credit was awarded, it tended to be for maintaining professional scepticism, reporting non-compliance to management or third parties and obtaining sufficient evidence in relation to compliance with law and regulations.

Requirement (c) – 4 marks

Describe substantive procedures which Teal & Co should perform in order to obtain sufficient and appropriate audit evidence in respect of ADDITIONS to Green Co's property, plant and equipment.

(4 marks)

For substantive procedures requirements, one mark is available for each well-described procedure, therefore candidates should aim to produce four tests for this requirement. Candidates should plan their time accordingly.

When describing substantive procedures one of the key things to consider is the level of detail provided. Many candidates fail to score well in this type of requirement because their procedures are vague or too brief. Tests must be sufficiently detailed noting clearly which source document should be used and for what purpose. Candidates must ensure that they can distinguish between a substantive procedure and a test of control. Many candidates lose marks in this type of requirement by mixing up these procedures. Where substantive procedures are required for an account balance subject to an accounting standard then considering the rules of the standard can help in generating targeted substantive procedures. The scenario for this requirement detailed that the company had incurred asset expenditure in refurbishing its retail stores to incorporate a cafe into each one and the scenario clearly stated that all of the costs had been recognised within property, plant and equipment (PPE). It is important to consider what issue the scenario contains, and this is then compared to the question requirement. Question requirements can sometimes focus on a specific assertion such as valuation or completeness, or on a particular element of an account balance, such as additions, and where this is the case, care must be taken to ensure that any substantive procedures listed only relate to this assertion or element. Spending time understanding the issue and carefully reading the question requirement ensures that any procedures listed are tailored and more likely to score marks. As the requirement was only for additions then general PPE procedures would not gain credit and it was disappointing that a significant proportion of candidates provided several generic PPE procedures.

When generating substantive procedures, it is important to ensure the tests have sufficient detail and are clear. For example, ‘agree the addition to an invoice’ without describing what the invoice is being reviewed for, such as cost to agree the valuation or that the invoice is in the company name to confirm rights and obligations would not score a full 1 mark. It is also important to stress what the source for the test is, for example ‘physical verification of existence of additions’ would only have been awarded ½ mark as the additions need to be selected from the non-current assets register to obtain the available 1 mark.

Procedures such as ‘casting the additions and agree to the non-current assets register’, ‘agreeing additions to invoices to ensure in company name and correct value recognised’, ‘recalculation of depreciation for the correct time period,’ and ‘reviewing the disclosure for compliance with relevant accounting standards’ would all gain credit.

In this session some candidates included procedures such as ‘obtain written representations,’ ‘reviewing the minutes for authorisation of the additions’ or ‘comparison against the prior year for the additions.’ Requesting written representation should be restricted to areas where the auditor is relying on management’s judgement or there is little independent evidence available. This is not the case with additions of PPE. These procedures would not gain credit as they were tests of control rather than substantive or they do not help to gather sufficient evidence relating to additions; tests must be tailored to fit with the requirement and scenario.

Requirement (d) – 6 marks

Identify and explain THREE quality management deficiencies in the approach adopted by Teal & Co and provide a recommendation which would have addressed each deficiency to ensure compliance with quality management requirements.

(6 marks)

When attempting a question such as this it is important that candidates spend a few minutes considering the aim of the requirement. They should consider whether this is a knowledge requirement solely based on ISA 220 *Quality Management for an Audit of Financial Statements*, or whether it is an application of knowledge from the ISA to the specific scenario. They should also consider whether the deficiencies required are those of Green Co, the client, or Teal & Co, the auditor.

The requirement does not contain a note specifying that the scenario is not needed, and therefore application of knowledge to the scenario is required. The requirement is clear that what is needed are ‘deficiencies in the approach adopted by Teal & Co’, therefore the focus should be on the auditor and not management.

The scenario contains details of the post-issuance review carried out for the audit of Green Co in line with the audit firm's quality management procedures. A review of the audit files identified a number of quality management deficiencies relating to how the audit was conducted. The requirement is for three quality management deficiencies and recommendations. Marks are awarded for identification of deficiencies (½ mark each), explanation of the implication of the deficiency to the audit firm (½ mark each) and an appropriate recommendation to address each deficiency (1 mark each).

When identifying the quality management deficiencies, candidates should work through the scenario line by line, taking a common-sense approach as to whether the steps taken by the audit firm seem reasonable and whether it would result in a high-quality audit being undertaken. The scenario contained more than the required number of deficiencies, and on the whole candidates easily identified a sufficient number of points. It was not unusual to see candidates list all four of the available deficiencies from the scenario.

Having identified the deficiencies, candidates then need to explain each deficiency. In considering this, it is important to think about the aim of the quality management procedures and what potential risk to the audit approach arises. The explanation needs to be specific to each deficiency, as it is not sufficient to state 'this could result in a failure to identify misstatements in the financial statements' or 'this could result in an inappropriate audit report conclusion' as all quality management deficiencies can ultimately lead to an incorrect audit conclusion or failure to identify misstatements. A clear understanding of exactly how the deficiency will result in a failure to identify misstatements or result in an incorrect audit opinion is needed. For example, for the deficiency of 'juniors missing the audit planning meeting', this can lead to a risk of team members not understanding or identifying the audit risks facing Green Co. Candidates who did not clearly state the impact on identification or understanding of audit risks would not have gained the available ½ mark. It was noticeable that many candidates did not provide any explanation, and simply identified the deficiency.

The next part of the requirement is for candidates to describe recommendations to ensure compliance with quality management requirements. To gain the 1 mark available it's imperative that the descriptions of the recommendations are sufficiently detailed, address the specific deficiency identified and are practical suggestions. For the 'audit team only audited educational organisations' deficiency some candidates provided vague responses such as 'senior and experienced auditors are required for the audit team' this would not have gained any credit. The specific issue is a lack of experience of retail or manufacturing companies; therefore, the recommendation should be that a different audit team is required, one which has experience of the industry in which Green Co operates. Additionally, recommendations must be actions rather than just objectives; recommendations which are phrased as 'ensure that….' are unlikely to gain much credit.

This requirement was unusual, however, those who considered the aim of quality management requirements and used the information available in the scenario, were able to score well. Candidates should be prepared for unusual requirements and take a common-sense approach in tackling them.

Francisco Co

This 20-mark question is based on Francisco Co, which is a wholesale food operator with 18 distribution depots and one central warehouse. This question tests candidates' knowledge of significant deficiencies in internal control, direct controls and tests of control and control deficiencies and recommendations.

Requirement (a) – 4 marks

(i) Define a significant deficiency in internal control; and

(ii) Describe THREE matters the auditor should consider in determining whether a deficiency in internal controls is significant.

(4 marks)

This is a knowledge requirement and has been tested in previous exam sessions. Some knowledge requirements, such as this one, have an opening statement, sometimes referenced to an ISA, and this is useful for setting the scene and providing clarification on the aim of the question requirement. Question requirements such as this demonstrate the importance of having a detailed understanding of the ISAs, and in this case ISA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*.

It is important to understand exactly what the question is asking, especially for knowledge questions, where candidates should be aiming to score full marks. It is also important that candidates note that they do not need to use the scenario to answer this requirement.

In this question, candidates were required to define a significant deficiency in internal control for 1 mark and describe matters in determining whether a deficiency is significant for 3 marks. The two sub requirements have different verbs with part (ai) being 'define' and the requirement verb in (aii) being 'describe.' Candidates need to ensure that they include sufficient detail for each of the requirements. Define is looking for a textbook or ISA specific definition, and a few lines would be sufficient as it only attracts 1 mark. For 'describe', simply providing a few words such as 'materiality of deficiency' is not enough. Candidates therefore need to consider whether they have written enough.

In part (ai) very few candidates were able to provide the definition of a significant deficiency which was disappointing as ISA 265 is a key standard for the syllabus area of internal controls. In requirement (aii) a commonly awarded point was 'leading to material misstatements' however, this would only gain ½ mark as it is too brief. To gain the additional ½ mark, candidates need to consider 'the likelihood of the deficiencies leading to material misstatements **in future financial statements**.'

It is also important that candidates pay attention to any elements of the requirement which are emphasised. In this session the word THREE was in capitals. This was specifically done to focus candidates' answers, so that they would know to provide only three well described answers. Additionally, there was a note under the requirement which stressed that the scenario did not need to be referred to in answering this requirement. Notes and capitalisation of words in requirements are there to guide and help candidates; candidates should be careful not to ignore them.

It is imperative that future candidates ensure that they devote adequate time to learning the knowledge areas of the syllabus as well as practising knowledge questions. Good questions to practice from the published sample questions include Silver Co September/December 2023, Petra Co March/June 2023, Daley Co September/December 2022, Whittaker Co March/June 2022, Pomeranian Co September/December 2021, Castle Couriers Co March/June 2021, Swift Co September/December 2020, Snowdon Co March/June 2020, Amberjack Co September/December 2019, and Freesia Co March/June 2019.

Requirement (b) – 6 marks

In respect of the system of internal control of Francisco Co:

(i) Identify and explain THREE DIRECT CONTROLS which the auditor may seek to place reliance on; and

(ii) Describe a TEST OF CONTROL the auditor should perform to assess if each of these direct controls is operating effectively.

(6 marks)

Marks are awarded for identification of direct controls (½ mark each), explanation of the implication of the direct control to the company (½ mark each) and an appropriate test of control for each control (1 mark each). In common with risk questions, the scenario will typically contain more than the number of direct controls required so it is important that candidates plan their time carefully and only attempt to list the required number of points. With this type of requirement good exam technique is critical.

As stated in previous Examiner's reports, candidates should be prepared to answer questions which cover direct controls and tests of controls, control deficiencies and recommendations or a combination of both. Francisco Co examines both direct controls and deficiencies, and each requirement focuses on three different parts of the system of internal control. Questions may also be set where direct controls and deficiencies are tested but in relation to a single part of a company's system of internal control or where each requirement relates to a different part of the system of internal control.

It is important that having read the question requirement, candidates take the time to ensure they fully understand what the requirement involves. This session there were a number of candidates who mixed up their deficiencies and controls and provided direct controls which were not complete and therefore were deficiencies.

The first step in tackling a question requiring both direct controls and deficiencies for the same internal control systems, such as Francisco Co, is to read through the whole scenario in full. This gives an understanding of what the potential answer points are for both direct controls and deficiencies. It is critical to be able to identify the different controls and deficiencies. If the scenario contains a control which is not operating effectively then this is a deficiency and NOT a direct control. For example, in this scenario we were told that ‘purchase invoices are matched to a copy of the relevant purchase order and these two documents are passed to the finance director for authorisation’ Candidates would not gain credit in the direct controls requirement for stating that ‘purchase invoices are matched to orders prior to being authorised’ as the invoices should also be matched to the relevant goods received note (GRN) and this is a deficiency which should have been listed in part (c) of the question.

When undertaking the first read through of the scenario it would be good exam technique to use the highlight function, using one colour for controls and a different colour for deficiencies. This would provide a visual aid for quickly spotting both controls and deficiencies. Having looked at the whole scenario and highlighted relevant points candidates should pick their three strongest points, re-read them from the scenario, drafting their answer as they go along. Do not be daunted by the length of the scenario, be methodical and keep re-reading the requirement to stay focused.

In order to be a direct control, candidates need to consider whether the control as described has been appropriately designed and is being operated in such a way that it would prevent or detect a material misstatement. Therefore, when identifying direct controls, it is important that the control described is complete. For example, the fact that ‘each employee has a staff identity card which they use to sign in and out of the depot at the beginning and end of each shift’ is not in itself a direct control. Additional checks would need to be undertaken to ensure that the identity cards are being used correctly. To be effective as a direct control the process of employees using their identity cards would need to be supervised by security staff or CCTV cameras which would ensure, for example, that staff are not signing in/out other employees.

Having identified direct controls, candidates then need to explain each control. In considering this it is important to think about what the aim of the control is e.g. what potential misstatement is being prevented or detected. The explanation needs to be specific to each control. It is not sufficient to state ‘this will prevent fraud and error’ as all controls aim to prevent or detect fraud and error in some way. A clear understanding of specifically how the control will prevent fraud and error is needed.

The last part of the requirement is for candidates to describe tests of controls for each direct control identified. To gain the 1 mark available the description of the test must be sufficiently detailed. A test which starts with ‘check’ is unlikely to provide sufficient detail as to how the auditor will test the control. Detail must be given on specifically what is being done to achieve a check, the word itself is not enough. Also, the control must be fully explained. For the control over the supervision of staff identity cards, simply recommending ‘observe the signing in/out process’ would only gain ½ mark as the test needs to state ‘to confirm that the process is supervised’ to gain 1 mark.

It must be remembered that tests of controls are procedures carried out by the auditor, therefore candidates need to ensure that they focus on what the auditor should do rather than provide recommendations for management.

In considering how to test the control, a useful starting point is to consider if there are any documents which can be inspected as this is likely to provide strong evidence that the control

is operating. However, when describing the test, it is important to clearly state the type of document being inspected and for what purpose.
In this session, the scenario contained a direct control where all purchase orders were authorised by responsible officials with varying authority levels. In testing this control an appropriate response would be that 'a sample of purchase orders should be inspected for evidence of authorisation by the relevant individual in line with the established authorisation levels.'

Tests such as 'observe' should be used sparingly as they do not generally score as well as inspection or some types of enquiry procedures. Where more reliable sources of evidence are available, these should be used to test the controls. In addition, candidates should ensure that they do not confuse tests of control with substantive procedures.

This session it was also disappointing to note some candidates restricted their answers in part (b) to the payroll system alone. It is not clear why this was the case as the requirement was clearly in relation to the company's system of internal control and so covered the payroll, purchases, and non-current assets systems. The scenario only contained two direct controls for payroll and so candidates who only considered payroll would have struggled to maximise their marks.

Direct controls and 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. The following published sample questions are all good questions to practice: Petra Co March/June 2023, Whittaker Co March/June 2022, Castle Couriers Co March/June 2021, Swift Co September/December 2020, Snowdon Co March/June 2020.

Requirement (c) – 10 marks

Identify and explain FIVE DEFICIENCIES in Francisco Co's system of internal control and provide a control recommendation to address of these deficiencies.
(10 marks)

Marks are awarded for identification of deficiencies (½ mark each), explanation of the implication of the deficiency to the company (½ mark each) and an appropriate control recommendation to address each deficiency (1 mark each).

Having already considered the scenario when answering part (b), candidates should re-read it focusing only on the identified deficiencies and draft their answer as they go along. When copying and pasting facts from the scenario, care must be taken to identify and record the actual deficiency from the scenario. Candidates can pick the fact from the scenario but fail to spot what the deficiency is.

This session a number of candidates identified irrelevant deficiencies which did not exist in this scenario. For example, 'purchase orders should be four-part,' however this was not a deficiency as the scenario stated that the orders were multi-part. It can only be assumed that candidates had learnt deficiencies from other questions and provided them in their answers, even though irrelevant.

Performance in this requirement was disappointing, with a significant number of candidates failing to provide five valid deficiencies. This was partly because some deficiencies were incorrectly identified as direct controls, for example ‘the payroll system automatically calculates the gross to net pay and produces payslips which are emailed to employees.’ If the payroll system calculates pay and then sends payslips this means that the calculations are not checked, and the risk of system errors is not addressed. In addition, some direct controls were incorrectly provided as deficiencies. For example, ‘access to standing data is restricted to managers through the use of a password which is changed monthly.’ Some candidates believed this was a deficiency as changing the passwords on a monthly basis was not sufficiently frequent and should be done daily, or that only allowing managers access to payroll standing data could cause issues if managers were ill.

Having identified deficiencies, candidates are required to explain the implication to the business to be awarded credit. For example, a valid explanation for the deficiency ‘automatic payroll calculations not checked’ (identification ½ mark awarded), would have been ‘system errors may not be identified leading to an under/overpayment of wages.’ Answers which just stated ‘payroll calculations may not be correct’ would not have gained credit as it does not state that system generated errors maybe missed and the impact on the wages paid to employees.

The explanation needs to be specific to each deficiency as it is not sufficient to state ‘this will result in fraud/error’ as all deficiencies can lead to increased fraud and error. A clear understanding of how the deficiency will result in fraud and error is needed. Also, it was apparent that some deficiencies were misunderstood by candidates. For the deficiency ‘some lease agreements and ownership documents cannot be located’, to gain the explanation marks it was important to understand that the documents had been lost and therefore might lead to additional costs for duplicate documents or affect the company if these assets were to be sold in future.

The next part of the requirement is for candidates to describe control recommendations. To gain the 1 mark available it is imperative that the description of the recommendation is sufficiently detailed. Additionally, recommendations must be actions rather than just objectives; recommendations which are phrased as ‘ensure that….’ are unlikely to gain much credit.

Candidates need to take care to ensure that recommendations are properly described, clearly address the specific control deficiency identified and are practical suggestions. For the deficiency of ‘cost centres being over budget for capital (asset) expenditure’, many candidates struggled to provide a sensible recommendation when ‘agreeing purchase orders for assets to the annual budget’ would have helped to prevent any overspend.

It is important that recommendations are as complete as possible. For the ‘invoices are not sequentially numbered’ deficiency, the recommendation of ‘invoices should be sequentially numbered’ would only gain ½ mark. The recommendation needs to also state that ‘regular sequence checks are undertaken’ to gain the other available ½ mark.

Some candidates incorrectly provided tests of controls rather than recommendations. Additionally, candidates must ensure that recommendations are focused on what management should do, rather than the auditor.

Good questions to practice from the published sample questions include Silver Co September/December 2023, Petra Co March/June 2023, Daley Co September/December 2022, Whittaker Co March/June 2022, Pomeranian Co September/December 2021, Castle Couriers Co March/June 2021, Swift Co September/December 2020, Snowdon Co March/June 2020, Amberjack Co September/December 2019, Freesia Co March/June 2019 and Camomile Co September/December 2018.

Cookit Co

This 20-mark question is based on Beeny & Co, an audit firm due to commence the audit of Cookit Co, which owns ten shops selling kitchen equipment. This question tests candidates' knowledge of substantive procedures and auditor's reports.

Requirements (a), (b) and (c) examine substantive procedures for inventory, trade payables and a redundancy provision and are for 5 marks each. The time allocation should be based on 1.8 minutes per mark, therefore, the available time should be split at 9 minutes for each of requirements (a) to (c).

One mark is available for each well-explained procedure therefore candidates should aim to produce 5 tests for each of the three requirements. Candidates must strive to understand substantive procedures and apply good exam technique. This includes tailoring procedures to the specific requirements of the question. Too often candidates have rote learnt a set of standard tests and these are then produced for each requirement without consideration of their relevance to the scenario provided. This approach tends to generate few marks. Audit procedures must be sufficiently detailed noting clearly which source document should be used. For example, tests such as 'review disclosures' would only score ½ mark. To score a full mark the procedure should go on to say, 'in accordance with accounting standards/relevant legislation'.

Requirement (a) – 5 marks

Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to the VALUATION of Cookit Co's inventory.
(5 marks)

The scenario for this requirement detailed that a range of cookery products endorsed by a celebrity chef, Remy Gusteau, had suffered a reduction in demand and therefore Cookit Co had stopped purchasing these products two months before the year end. The year-end inventory included $1.7m of these product lines.

It is important to consider the issue contained in the scenario and then compare this to the question requirement. The key words in this requirement are 'substantive', 'valuation' which is in capitals, and 'inventory'. It is clear that the substantive procedures must focus on whether inventory in general, as well as for the Remy Gusteau products, are valued appropriately at the year end. It is important to have noted that the inventory was all finished goods which are not manufactured by the company. Therefore, any tests relating to work in progress (WIP) and standard costs will not be credited.

Spending time understanding the issue and carefully reading the question requirement ensures that any procedures listed are tailored and more likely to score marks. As the requirement was for valuation, the procedures need to focus on confirming the cost of the inventory, confirming the net realisable value (NRV) and considering whether any write down or allowance is required. Additionally, any other procedures which might flag that inventory, including the Remy Gusteau products, are overvalued would also gain credit. Lastly it is important to appreciate that as the requirement only relates to the valuation assertion, any general inventory procedures such as existence or cut-off testing are not relevant and so would not gain any credit. This clearly highlights the need to tailor tests to the specifics of the scenario and requirement rather than producing a list of rote-learned procedures.

In this session however many candidates included procedures such as 'recalculate WIP based on stage of completion,' 'discuss the basis of the WIP with management', 'during the inventory count physically inspect this product line,' 'agree the standard labour costs to payroll records', 'review the overheads included to ensure they are of a production nature' and 'review the disclosure of this inventory in the financial statements'. These procedures would not have gained credit as they were not focused on valuation of purchased finished goods.

Candidates must ensure that they can distinguish between a substantive procedure and a test of control. Many candidates lose marks in this type of requirement by mixing up these procedures. For example, in this session many candidates provided test of controls which would be undertaken when attending the inventory count, rather than providing substantive procedures for valuation.

When generating the substantive procedures, a sensible approach would be to firstly consider how to verify cost and then how to assess the NRV. A procedure such as 'agreeing the costs to recent purchase invoices' would have confirmed the cost for 1 mark. Then moving onto NRV and 'reviewing a sample of post-year-end invoices to assess if the NRV is above cost' would gain another 1 mark. When considering NRV it is important to ensure that the tests provided are focused and detailed, as procedures such as 'confirm inventory is valued at the lower of cost and NRV' or 'carry out NRV tests' will not gain credit as there is no detail of how this confirmation will occur.

Having tested both cost and NRV, further consideration should be given to assessing whether total inventory may be overvalued. Procedures such as 'review the aged inventory report for slow-moving items and discuss with management whether an allowance is required' and the analytical procedure 'calculate the inventory holding period and compare to the prior year and investigate any significant differences' would each gain 1 mark. When generating analytical procedures, review of the gross profit margin would not gain credit as movements in this margin are not closely related to inventory valuation.

Requirement (b) – 5 marks

Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to the COMPLETENESS of Cookit Co's trade payables.

(5 marks)

The scenario for this requirement detailed that the accounts payable clerk left in January 20X5 and no replacement had been hired; also that no supplier statement reconciliations had been undertaken since December 20X4. The payables payment period and total payables were provided for the current and prior year, which illustrated that payables had fallen.

The question requirement once again focused on a specific assertion, in this case completeness, and care must be taken to ensure that the substantive procedures given only relate to this assertion as any procedures not related to completeness would not gain credit. Procedures such as 'casting the list of individual suppliers (payables listing) and agreeing to the trial balance and financial statements', 'reviewing after-date-cash payments and agreeing to the list of individual suppliers for the relevant period', and 'performing supplier statement reconciliations and investigating any reconciling items' would all gain credit.

In this session some candidates included procedures such as 'review whether the disclosure is in accordance with accounting standards' or 'obtain written representations.' These procedures would not gain credit as they do not help to gather sufficient evidence as to the completeness of trade payables and accruals. Requesting written representation should be restricted to areas where the auditor is relying on management's judgement or there is little independent evidence available. This is not the case with completeness of payables and tests must be tailored to fit with the requirement and scenario.

Additionally, some candidates focused on why the payables clerk had left and whether they had been replaced, these procedures did not gain any credit as they are not substantive procedures focused on the completeness of payables.

Some candidates had not read the scenario carefully as it clearly stated that a trade payables confirmation (circularisation) would not be performed, therefore no credit was awarded for this procedure. Additionally, some candidates went further and listed the steps which should be followed when undertaking a confirmation.

When generating substantive procedures for trade payables or trade receivables, it is important that the focus of the tests is on the statement of financial position balance rather than on purchases or revenue. In this session some candidates incorrectly provided purchase procedures such as 'agree goods received notes to purchase invoices' with no reference to the list of individual suppliers/payables ledger and these did not gain credit. Take the time to read the question requirements carefully and spend time thinking about what is needed prior to producing an answer.

When describing substantive procedures, one of the key things to consider is the level of detail provided. Many candidates fail to score well in this type of requirement because their procedures are vague or too brief. Tests must be sufficiently detailed, noting clearly which source document should be used and for what purpose. For example, in this session some candidates included, ‘review post-year-end payments’ and would have only gained ½ mark. In order to gain the 1 mark available this test would need to be expanded to ‘follow these through to the list of individual suppliers/ payables ledger’.

In many substantive procedure questions analytical procedures can be an important source of evidence, but for one-off types of expenditure, analytical review is unlikely to be useful. For trade payables, valid analytical procedures such as ‘comparing the trade payables to the prior year with significant differences being discussed with management’ would gain the full one mark. Candidates who ‘compare the balance to the prior year to identify any significant differences’ only gained ½ mark as the process of comparing current to prior year only identifies the differences. To gain the other ½ mark these significant differences need to be investigated or discussed further with management.

Requirement (c) – 5 marks

Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Cookit Co’s redundancy provision.

(5 marks)

Good exam technique is important for a requirement like this. While some knowledge of accounting for redundancy provisions would have been helpful, the key here is to think logically. It is possible to produce a good answer by thinking through the issues which are relevant for any provision, for example whether it should be recognised and if so, at what amount. Procedures can then be designed to address these issues using the information from the scenario to add detail.

Straightforward procedures which gained credit in this session included ‘recalculating the redundancy provision and agreeing it to the payroll records/employment contracts’, ‘reviewing employee correspondence to confirm the announcement was made pre year end’, ‘reviewing board minutes to ascertain the probable amount and likelihood of payment,’ ‘obtaining written representations on managements view of the completeness of the provision’ and ‘reviewing the disclosures for compliance with IAS 37/accounting standards.

Careful thought should be given to the nature of the provision and the context of the scenario. This was a redundancy provision, not a legal claim, and so contacting the lawyers would not generate any useful evidence and would not gain any credit. Additionally, the scenario specified that the shop was expected to close in September and the final audit was due to start shortly after 1 July. Therefore, it was highly unlikely that the auditors would be able to ‘review the post-year-end cashbook for payments made and agree this to the provision’ as the payments would be made in October at the earliest; hence any procedures which considered the post-year-end payment would not gain any credit.

Additionally, some candidates did not consider the one-off nature of this provision and therefore ‘comparing the provision for the current year to the prior year’ will not provide useful evidence as it is unlikely the company had a similar redundancy in the prior year. Other common inappropriate tests focused on generic payroll procedures, going concern tests and procedures to verify whether the shop which was closing was in fact unprofitable. Candidates must carefully read the information in the question and tailor their answers accordingly.

Good questions to practice from the published sample questions are Latte Co September/December 2023, Heron Co March/June 2023, Pacific Co September/December 2022, Spinach Co March/June 2022, Danube Co September/December 2021, Purrfect Co March/June 2021, Sagitarrii & Co September/December 2020, Encore Co March/June 2020, Spadefish Co September/December 2019, Hyacinth Co March/June 2019, Jasmine Co September/December 2018 and Gooseberry Co March/June 2018.

Requirement (d) – 5 marks

Discuss the issue and describe the impact on the auditor’s report, if any, should this issue remain unresolved.

(5 marks)

Although auditor’s reports feature regularly in the AA exam, there are several ways in which they can be tested, and candidates must be prepared for any type of question. The issue in this question which needed to be considered related to the proposal by management not to include the redundancy provision of $1.8m as the closure of the shop was post year end. Questions on auditor’s reports have shown a gradual improvement in recent exam sessions and performance for this question was satisfactory.

Marks are awarded for a discussion of the issue (1 mark), assessment of the materiality of the issue (1 mark), a description of the type of modification (up to 2 marks) and the resultant impact on the auditor’s report (1 mark).

In order to be awarded the mark for discussing the issue, candidates should not just re-write the fact from the question. Candidates need to explain that the formal closure plan was announced pre year end and so a constructive obligation exists at the year end (½ mark), and that without inclusion provisions/liabilities would be understated and profit overstated (½ mark). Recent exams have seen an improvement in candidates’ discussion of the issue, however, this session it was disappointing to see that many did not gain the available 1 mark as very few candidates stated that the provision was understated or profit overstated.

Candidates were able to correctly calculate materiality, gaining ½ mark with a further ½ mark for the assessment that this was material. Also, candidates satisfactorily described the type of modification and the impact on the auditor’s report. When considering the type of modification, candidates are reminded that no credit is awarded for ‘qualified report’ or ‘the audit report is modified’ as it is the opinion rather than the report which has been modified. Some candidates continue to list all possible options in a scatter gun approach, and this simply wastes time.

Auditor’s reports are a core area of the syllabus and knowledge of the ISAs in this area is imperative. Good questions to practice from the published sample questions are Pacific Co September/December 2022, Spinach Co March/June 2022, Danube Co September/December 2021, Purrfect Co March/June 2021, Sagitarrii & Co September/December 2020, and Encore Co March/June 2020.