ACCA

Advanced Audit and Assurance (AAA) September/ December 2025 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.

Contents

General comments

This examiner's report should be used in conjunction with the published September/December 2025 exam which can be found on the ACCA Practice Platform.

In this report, the examining team provide constructive guidance on how to answer the questions while sharing their observations from the marking process, highlighting the strengths and weaknesses of candidates who attempted these questions. Future candidates can use this examiner's report as part of their exam preparation, attempting question practice on the ACCA Practice Platform and reviewing the published answers alongside this report.

Format of exam

The Advanced Audit and Assurance (AAA) examination comprises two sections. Section A contains one compulsory question for 50 marks in total. Section B has two compulsory questions for 25 marks each. Out of this total of 100 marks across sections A and B, 20 marks were available for professional skills related to communication, commercial acumen, analysis and evaluation, and professional scepticism and judgement and 80 technical marks were available for applying appropriate technical knowledge in response to the requirements.

Section A

Question 1 – Mistral

> It is 1 July 20X5. You are a manager in the audit department of Sirocco & Co, a firm of Chartered Certified Accountants. You are assigned to the audit of Mistral Co, a listed entity, which has a financial year ending 30 September 20X5 and is a new client of your firm.
>
> Mistral Co operates in the renewable energy industry and specialises in manufacturing and installing wind turbines for use in onshore and offshore wind farms (an area covered with wind turbines on land or at sea).

Format of the question

This question was a typical Section A question set at the planning stage of the audit of Mistral Co, a listed company which operated in the renewables energy industry and specialised in manufacturing and installing wind turbines for use in wind farms. The question contained requirements focusing on an evaluation of the significant business risks faced by the company, evaluation and prioritisation of the significant risks of material misstatement (RoMM), suitable audit procedures for gathering evidence in relation to development costs which had been recognised as intangible assets and finally a discussion of the ethical and professional issues arising from a request for an additional service made by the company's audit committee. The Section A question is typically where candidates perform best and the recent trend for more focused answers continued this session although there continues to be areas where significant improvement is still required.

The company in the scenario was a new client to the audit firm and a listed entity which operated in a specialised industry. Candidates should note that they are not expected to have detailed industry specific knowledge when answering questions in this examination and the scenario will always have enough information to enable sufficient specific risks to be identified and evaluated to achieve full marks.

Several exhibits were provided to candidates to enable them to develop an understanding of the specific issues relevant to the audit. These were as follows:

1.	Partner's email – an email which you have received from Lin Ghibli, the audit engagement partner.
2.	Background information – information about the company relevant to the audit planning
3.	Internet search results – the headline results from an internet search performed by the audit team about the company and industry.
4.	Meeting notes – summary of matters discussed at a recent meeting between the company's finance director and the audit engagement partner.
5.	Request from the audit committee – a request for an additional service they would like Sirocco & Co to consider.

In this question, candidates were given very specific directions in the partner's email regarding which exhibits to use for each requirement, and it was pleasing to note that in the majority of cases these instructions were followed.

As always, candidates are encouraged to spend adequate time reading and planning and should aim to obtain a holistic view and understanding of the issues present in the question before compiling their answer. Where there is evidence of candidates taking this time and planning their answer, responses tend to be more structured and focussed which generally increases the chances of candidates scoring strong technical as well as professional skill marks.

Exhibit 1 – Partner's email

In a Section A question, the partner's email will always set out the detailed requirements which are to be answered and the mark allocation. It is recommended that **candidates refer to the partner's email first** to ensure that they understand what they are being asked to do as they read through the detailed information and to help them consider the best way to allocate their time to each requirement.

To: Audit manager
From: Lin Ghibli, audit engagement partner
Subject: Audit planning for Mistral Co
Date: 1 July 20X5

Hello

I have provided you with some information to help you with planning the audit of our new client Mistral Co for the financial year ending 30 September 20X5. In line with Sirocco & Co's internal quality procedures, revenue will be used as the basis for determining materiality.

I require you to prepare briefing notes for my own use in which you:

(a) Using Exhibits 2 and 3, evaluate the significant business risks facing the company.
(8 marks)

(b) Using Exhibits 2, 3 and 4, evaluate and prioritise the significant risks of material misstatement to be considered in planning the audit.

Using revenue as your benchmark, you will need to determine and apply an appropriate materiality threshold in your briefing notes.
(18 marks)

(c) Design the principal audit procedures which should be performed in relation to the development costs of the Zephyr II wind turbine which have been recognised in intangible assets referred to in Exhibit 4.
(6 marks)

(d) Using Exhibit 5, discuss the ethical and professional issues arising from the request made by the audit committee and recommend any actions which need to be taken by Sirocco & Co.

Note: Candidates should assume it is not required under legislation of the country in which Mistral Co is based, to provide a separate sustainability report with the integrated report.
(8 marks)

Thank you.

The requirements of this question were split into four parts. Requirement (a) of the question asked candidates to evaluate the significant business risks facing Mistral Co. Requirement (b) asked candidates to evaluate and prioritise the significant RoMMs present in Exhibits 2, 3 and 4. Requirement (c) asked candidates to design the audit procedures to be performed in relation to the development costs, recognised in intangible assets in relation to the development of a new model of wind turbine. Finally, requirement (d) asked candidates to discuss the ethical and professional issues arising from the audit committee's request for the firm to assist in the preparation of, and assurance on, the company's sustainability report. In all versions of the exam, candidates were advised to assume that there was no legislative requirement for the company to produce a separate sustainability report.

Professional skills marks were available for all four of the professional skills associated with the syllabus.

General comments

Well prepared candidates scored good marks on this question, particularly when focusing on the specific scenario. Where a candidate prepared an answer tailored to the scenario and focused on the requirement, high technical and professional skills marks were obtained.

Some candidates continue to produce vague and generic answers which were not tailored to the scenario and, therefore, did not achieve high technical or professional skills marks. Many candidates continue to fall short of the required depth of analysis which is needed at this level to support their answer. This exam requires candidates to demonstrate a high level of technical knowledge, but they also need to be able to apply this knowledge to the specific context of the scenario presented. Generic or high level responses which do not build on the detail provided in the scenario will gain little to no credit. Candidates should use the specific information provided within the scenario to demonstrate both knowledge and application of skills to pass each requirement.

Candidates are also reminded to remember their audience when writing their answers; the briefing notes are for the audit engagement partner and therefore there is no need to explain basic technical points such as what a business risk is, how audit risk is managed or how to calculate materiality. These types of answer points will score no credit.

Requirement (a) – 8 marks

(a)	Using Exhibits 2 and 3, evaluate the significant business risks facing the company. (8 marks)

In this section of the question, candidates were required to use the specific information provided in the scenario to evaluate the business risks facing the company. In the AAA exam and in line with ISA 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement*, an evaluation of business risks should include those risks which would have a significant impact on the client business and where there is a significant probability of these risks occurring, after any mitigations stated in the information provided. Risks that are of a remote likelihood of occurring, already mitigated against or which will have an insignificant impact are not considered relevant to the evaluation. Candidates are required to identify what is significant in the context of the specific scenario, demonstrating good professional judgement and an ability to disseminate the important information while assessing the risks.

This requirement was generally well answered, with many candidates able to identify and evaluate the risks surrounding the company's increasing raw material costs and increasing requirements for strict health and safety regulations in the industry. Most candidates were able to successfully identify the challenges associated with an industry with significant cash requirements but very long lead time in terms of contract fulfilment. Better answers used calculations to support their analysis and demonstrate the decline in the company's profit margins.

Strong answers were also able to discuss the challenges the company was facing in relation to the Zephyr I (Z1) model and the impact this was likely to have on profitability and customer demand. They were able to discuss the overall significance of the costs which might be involved to rectify the issues and the effect on the company's reputation if contracts which had already been signed could not be honoured. Strong candidates were also able to demonstrate appropriate understanding that there is the need to continually develop new models of turbine in order to compete in the industry. This means that the company has to commit significant amounts of cash into research and development which does not always lead to viable products. Candidates who were able to discuss this aspect of the competitive industry clearly demonstrated the skill of commercial acumen and were awarded professional skill marks accordingly.

Most answers identified the risk associated with the transportation of the large wind turbines. They were able to evaluate the impact this might have on the company's projected revenue and profitability in the current year due to the inability to satisfy the contract obligation. Better answers also considered the wider implications of this, by discussing the possible additional costs of storing the turbines until they could be delivered. Only the best answers discussed that these issues could be more widespread and that other contracts may also be affected. Some candidates also demonstrated appropriate professional skill by discussing that the company would be reliant on the relevant local authority to grant the necessary approval before the contract could be completed, further exacerbating the overall level of risk.

Many answers also identified the risk associated with the recent lack of approval for new wind farms due to a slow and complex approval process. Many answers were able to discuss that was likely to have a significant impact on the company's revenue and cash flow due to a reduction in demand for wind turbines in at least the short term. However, some candidates misunderstood the information presented in the scenario regarding the approval process, suggesting that Mistral Co would be eligible for fines and penalties if they did not adhere to targets for clean energy.

Many candidates challenged the appropriateness of the company operating a 'just in time' inventory system, inappropriately suggesting that the company must be advised to overhaul their inventory system. This demonstrated a lack of commercial understanding regarding such an inventory system, such as Mistral Co, where it would be inappropriate to hold large levels of inventory. It also shows a lack of understanding of the role of the auditor and the reason why candidates are required to assess business risk. While it may be appropriate for an auditor to make observations regarding business practices, it is not the role of the auditor to question the company's established business model. Further, there was nothing in the scenario to suggest that the company had issues regarding inventory management and therefore these comments were deemed speculative by the examining team.

Some candidates continue to mix up business risk and RoMM resulting in an answer which is very muddled or cannot score any credit as it is explained from the wrong perspective. Disappointingly, some answers to this requirement focussed on either risk mitigations or auditor's responses which was not requested and therefore were unable to score marks.

Candidates are reminded that they are **not required to prioritise the business risks**, this requirement relates to the **evaluation of RoMM only**, and candidates should not waste time providing this additional information. Candidates are again reminded to read the requirement carefully and to ensure that they have conducted adequate question practice to ensure they have developed appropriate exam technique. To assist candidates in their responses, the examining team do specify the appropriate exhibits to be used when answering the requirements.

Overall, in this section many candidates were able to evaluate sufficient risks to pass the requirement, and many candidates did not seem to have difficulty in identifying business risks and the implication on the company; however, the differentiator between stronger and weaker candidates continues to be their ability to evaluate the risks fully and demonstrate their professional skills of analysis and evaluation and commercial acumen.

Requirement (b) – 18 marks

> **(b)** Using Exhibits 2, 3 and 4, evaluate and prioritise the significant risks of material misstatement to be considered in planning the audit.
>
> Using revenue as your benchmark, you will need to determine and apply an appropriate materiality threshold in your briefing notes.
>
> (18 marks)

This requirement is typical in volume and nature to many planning questions and examines a major area of the syllabus – evaluation of the risks of material misstatement. Candidates were directed to use Exhibits 2, 3 and 4 to evaluate **AND** prioritise the RoMMs relevant to the audit

There were 18 technical marks available in this part of the question in addition to a significant number of professional skills marks for the analysis. It was disappointing to see that some candidates are still obtaining few marks for this type of requirement as they continue to rely on basic or generic explanations, which fail to refer to the information in the scenario. Candidates should refer to the specific information, provide more in-depth answers and assess the scale of the risk in the context of the specific audit client to obtain maximum credit.

Materiality

Specific marks were available in this requirement for the calculation and application of materiality in line with the syllabus guidance. While a significant number of candidates appeared prepared and followed the materiality guidance provided by the examining team, a significant number continue to fail to apply this guidance and lost out on valuable technical and professional skills marks as a result.

Candidates are expected to determine an initial materiality threshold for the audit, as would be required in practice. Three technical marks are available for the materiality determination. Candidates are expected to demonstrate a knowledge of the appropriate percentage range for the benchmark as instructed by the audit engagement partner (in this question, revenue was to be utilised with candidates expected to use somewhere between 0.5% and 2% as their range) and calculate the monetary amount in respect of the range. Candidates must then use their professional judgement to select an appropriate materiality threshold given the risk levels which exist in the audit and provide a brief justification for their choice. Each of these steps examines a different aspect of the understanding and skills required of an auditor.

Generally, the requirement to determine and apply materiality continues to be poorly handled. Many candidates ignored the guidance in the partner's email and used a different benchmark or produced the wrong calculations. Candidates are reminded to read the financial information provided in the question carefully as there is a significant difference between calculating 0.5% of **$4.762 million** and **$4,762 million**. In this session, many candidates used incorrect numbers which resulted in an exceptionally low materiality level which would be inappropriate for the audit of a listed entity. Candidates should ensure that they sense check their calculations and consider whether the materiality level they have suggested seems appropriate in the context of the scenario.

Some candidates wasted time by doing all the calculations correctly but then failed to apply their own materiality threshold throughout their answer, and reverted to doing calculations for each item based on total assets or profit. This resulted in many candidates wasting valuable time and failing to score the professional skills marks attached to this area. A few candidates also inappropriately used the prior year financial information, again demonstrating a lack of understanding and professional judgement.

It was also disappointing to note that some candidates failed to justify why they had selected their chosen materiality threshold for the audit. The examining team will give credit for any reasonable explanation of the chosen materiality threshold, as the mark is to reward candidates who can justify their response through the application of professional judgement. It is not required that candidates select the identical percentage or figure, or that they provide a justification identical to that shown in the model answer. However, simply stating that ‘materiality has been set at a specific value due to the risks which have been identified’ or because the audit is ‘high risk’ is not considered a suitable explanation by the examining team, and will not be awarded credit. Conversely, setting materiality at the lower end of the range simply because the company was listed does not give adequate consideration to the risk profile of the audit. Many candidates used these types of comments as their explanation and therefore were not able to score the full technical marks in this area.

It continues to be disappointing to note that some candidates still do not understand the relationship between audit risk and materiality. As seen in the previous session, some candidates concluded that as there was a high level of risk present within the audit, the materiality level could be increased, thus failing to understand that there is an inverse relationship between audit risk and the materiality level which should be set. Understanding this relationship is a basic principle and assumed knowledge. Candidates are encouraged to revisit the principles of materiality which were explored in Audit and Assurance (AA) at the Applied Skills level.

Evaluation of the risks of material misstatement

Using Exhibits 2, 3 and 4, candidates were required to evaluate and prioritise the significant RoMMs to be considered in planning the audit. In any effective risk evaluation, candidates need to demonstrate an understanding of risk, how it arises and how the audit will focus on those issues most likely to cause a material misstatement. Candidates who demonstrated a depth of evaluation were awarded more credit than those providing generic responses. Performance on this requirement was mixed.

The majority of candidates were able to identify the RoMM associated with the recognition of revenue in relation to the new support service which was being offered by

Mistral Co. Many candidates were able to discuss that the introduction of this new service changed the performance obligations in the affected contracts, and that this revenue should be recognised over time, rather than at a point in time and therefore, there was a risk that revenue was overstated as a result. However, few candidates demonstrated a full understanding of how this revenue should be recorded in the financial statements, failing to understand that there would also be an understatement of the associated contract liability. Revenue recognition is a key area of financial reporting and candidates are reminded that they should ensure they have sufficient knowledge and understanding of this fundamental accounting standard.

Better answers demonstrated a good understanding of the requirement of IFRS® 15 *Revenue from Contracts with Customers*, that where a contract has multiple performance obligations, revenue should be allocated to those performance obligations by reference to their relative standalone selling prices. The strongest answers also made a connection that there was a risk of management bias and that this revenue was perhaps being recognised early in order to minimise the impact of increasing costs in the year on the company's profitability.

Disappointingly few candidates discussed this new revenue stream in the context of IFRS 8 *Operating Segments*, despite a very clear indication in the scenario that the company did not intend to disaggregate revenue and report this operating segment separately. Candidates who did recognise this as a risk were able to score marks for concluding that it was an operating segment which should be reported in line with IFRS 8 by calculating that it represented 11.5% of revenue and it was being actively monitored by the board of Mistral Co.

Many candidates were also able to identify the issue relating to the possible legal claim which might be raised against Mistral Co as a result of the injuries sustained by employees involved in turbine repairs. Most candidates who evaluated this risk were able to score technical marks for demonstrating awareness of the requirements of IAS® 37 *Provisions, Contingent Liabilities and Contingent Assets* in terms of when a provision should be recognised. However, it was disappointing to see that most candidates did not accurately apply the requirements of IAS 37 to the specifics of the scenario. Based on the information provided, while it could be established that the company was likely to have an obligation due to a past event, ie the accident and subsequent injuries had occurred, it could not be determined whether a payment would be probable or for how much the company would be liable. Therefore, at the financial year end it was more likely that this would constitute a contingent liability which required disclosure. The analysis provided by many candidates jumped straight from the requirements of IAS 37 to a conclusion that liabilities and expenses would be understated as a result. This level of analysis is a typical example of where candidates do not tailor their answers and severely limit the amount of technical and professional skill marks which can be awarded.

The risks arising in relation to the company's intangible assets were less well tackled. Most answers were able to demonstrate understanding that the issues identified with the Z1 wind turbines were an indicator of impairment and therefore the development costs in relation to this model should be tested for impairment. The majority of candidates were able to conclude that there was a risk that intangible assets were overstated. Very few candidates, however, considered how that impairment review would be performed and only the very best answers discussed that due to the fact that all sales of this model had been suspended, it was likely that the value in use calculation would be severely diminished. Consequently, this would result in a significant impairment loss. Candidates who did make this connection demonstrated high levels of professional scepticism and were awarded both technical and professional skill marks accordingly.

Many answers also discussed the risk connected with the company's approach to setting amortisation rates for intangible assets and demonstrated knowledge of the guidelines set out in IAS 38 *Intangible Assets*. Better answers confidently discussed that the lifespan of an average installed wind turbine (15 years) would be an inappropriate basis for amortisation of the Z1 model. Only the strongest answers suggested that a four year useful life might be more appropriate given that four years is the average product life cycle of this model of wind turbine. However, many candidates incorrectly discussed that amortisation should not commence at the point at which the company starts to produce the model displaying a lack of understanding of the guidance in IAS 38 regarding when an intangible asset is ready for use.

The answers in relation to the $550 million of development costs which were recognised in the year as a result of the development of the Zephyr II (Z2) model were on the whole disappointing. Most candidates who assessed this aspect of the risk were able to state that certain criteria should be met prior to inclusion in intangible assets, but many demonstrated a lack of understanding as to what those criteria are or failed to assess whether in the circumstances presented, they have been met. Only strong answers were able to explore the connection between the Z1 and Z2 development costs and challenge whether technical feasibility for the Z2 model had actually been met due to the design issues which had now been identified regarding the Z1 model.

Finally, very few candidates discussed the possible risk of onerous contracts as a result of the increasing costs of raw materials and declining profit margins being experienced by the company during the year. It was disappointing to note that some candidates correctly identified and mentioned the risk of onerous contracts when evaluating the company's business risks, but then failed to make the connection as to how this would translate as a RoMM in the company's financial statements. Candidates must ensure that they understand why an auditor considers the business risks faced by a company and that the objective is to gather sufficient understanding of the business to assist the auditor in identifying RoMMs. In the AAA exam, these requirements should not be addressed completely in isolation to each other as considering the business risks should be seen by candidates as the foundation for going on to evaluate the RoMMs.

Prioritisation of RoMM

A high proportion of answers failed to provide any indication of how the risks were prioritised, therefore failing to follow a key instruction in the partner's email and lost out on valuable professional skill marks as a result. Candidates can demonstrate their prioritisation in a variety of ways, including providing some justification as to why a risk is prioritised throughout their answer or in a conclusion provided somewhere in their answer. To score these marks, candidates **must do more than simply say these risks are a priority as they are material or that their answer lists the risks in order of priority**. Only risks of material misstatement are relevant to the requirement and therefore candidates must demonstrate additional reasoning as to why specific risks are more important. Candidates are encouraged to review the model answers to gain understanding of what is expected in relation to this requirement.

Requirement (c) – 6 marks

(c)	Design the principal audit procedures which should be performed in relation to the development costs of the Zephyr II wind turbine which have been recognised in intangible assets referred to in Exhibit 4. (6 marks)

Requirement (c) is typical of a section A question and required candidates to suggest audit procedures to address a specific area of risk arising in the question. In this question, candidates were asked to design the principal audit procedures which should be performed in relation to the $550 million of development costs which had been recognised in the year in relation to the development of the Z2 wind turbine. Answers to this requirement were mixed. Similar to the points covered above regarding the risks, many candidates were unable to convert their accounting knowledge in relation to intangible assets into appropriate audit procedures.

The weakest answers focussed on obtaining a breakdown of the development costs and confirming mathematical accuracy and suggesting that they be assessed to determine if it was appropriate for them to be included in intangible assets, without providing any detail of how this could be achieved. Answers of this nature scored minimal marks and no professional skill marks. These procedures, while likely to be included as a starting point in an audit work programme, provide little to no evidence for the auditor over the key risks connected to the recognition of the development costs. Weaker answers also suggested reviewing board minutes or obtaining written representations to confirm approval for the development project or that costs had been appropriately recognised in intangible assets. This demonstrates a lack of professional judgement in terms of when it is appropriate to rely on this type of evidence. However, where candidates developed the review of the board minutes to a more pertinent area, such as discussion of the impact of the Z1 issues on the new Z2 model, credit was awarded.

Many candidates also suggested agreeing the $550 million to bank statements which would not be possible or agreeing the suitability of the costs to industry information which is unlikely to be available to the auditor, given the specialised nature of the products.

Many answers also failed to provide enough procedures in order to score all the technical marks available. Candidates are reminded that one mark is available for each well written procedure which has a clear source and purpose and is relevant to achieving the key audit objective of gathering **sufficient and appropriate** audit evidence.

Better answers agreed development costs to appropriate source documentation such as invoices or employee timesheets, as a means to determine if costs were appropriately included in intangible assets. Candidates who used the criteria set out in IAS 38, such as the consideration of technical feasibility, the company's ability to complete or sell the intangible asset and resources to complete the intangible asset, as a way to structure their answer scored higher marks. The strongest answers were those which also considered the impact of the issues identified with the Z1 model in order to design procedures to determine how these issues had been rectified, the impact on the Z2 development costs and the possible need for impairment.

The strongest candidates gained a professional skill mark under analysis and evaluation for designing procedures which addressed the areas of judgment and risk involved in determining the suitability of the costs which had been recognised in intangible assets.

Requirement (d) – 8 marks

(d)	Using Exhibit 5, discuss the ethical and professional issues arising from the request made by the audit committee and recommend any actions which need to be taken by Sirocco & Co. **Note: Candidates should assume it is not required under legislation of the country in which Mistral Co is based, to provide a separate sustainability report with the integrated report.** (8 marks)

Requirement (d) asked candidates to discuss the ethical and professional issues arising from a request for additional services by the audit committee of Mistral Co. Exhibit 5 detailed the request relating to assistance with, and assurance on, a sustainability report which the company was looking to publish for the first time as part of their integrated report.

The responses to this requirement were mixed. Better answers were able to correctly identify and fully explain the self-review threat arising from providing assurance on sustainability measures. This might relate or refer to information which has been subject to audit and that the team might be unlikely or unwilling to challenge information which has already been audited by the firm. Many candidates stated that the use of a separate team would be a suitable safeguard to mitigate for this threat, but the use of a separate team was clearly stated within the question, and therefore was not awarded credit as a result.

Many candidates were also able to correctly identify that there was a risk that the firm would assume management responsibilities by providing the additional service, but this was not always explained from an appropriate perspective. It was not the provision of the assurance on the sustainability report which would give rise to this threat, but rather the request from the audit committee that the audit firm be involved in determining and setting the measures which should be reported on. Unfortunately, many candidates were, therefore, not able to score full marks in relation to this issue. Better answers were able to conclude that while the firm must not be involved in setting the information in the report the service to provide the assurance could be accepted as long as the audit committee understood its responsibilities in this regard.

Only better answers were able to provide appropriate discussion regarding the self-interest threat arising from the offer of an increase to the audit fee on the basis that the work was favourable and in line with the expectations of the audit committee. Many candidates were able to discuss that the IESBA International Code of Ethics for Professional Accountants (or other relevant local equivalent in the UK, IRL and SGP versions of the exam) has specific guidance or prohibition around the use of contingent fees for audit clients. However, a significant number of candidates described the self-interest threat in relation to possible fee dependency on the client rather than in relation to the basis of the fee. There was nothing in the scenario to suggest that this would be the case and candidates are reminded that they will always be provided with sufficient detail to come up with relevant ethical threats rather than speculative ones.

Furthermore, at AAA level candidates are again reminded that in order to score the technical marks it is not sufficient to only demonstrate knowledge of the threats, they must be appropriately applied and explained in the context of the scenario. This is also a key professional skill – the audit engagement partner, for whom the briefing notes are being prepared, will not need to be educated on what a self-interest or self-review threat is, for example, but will want to know why this threat specifically arises in the circumstances presented. Candidates are therefore reminded that to score full marks in relation to the ethical issues they must do more than simply state it is a self-interest threat; they must **explain the implications of the threat**. In this instance, the self-interest threat may result in the firm being motivated to produce the expected outcome in order to gain the income.

Many candidates were able to go on to discuss the risk that the firm might not have the necessary expertise to provide assurance on the sustainability measures due to the very specialised nature of the industry, or the necessary resources to complete the work within relevant timescales. Marks were also awarded to candidates who discussed the overall level of risk which might be attached to an engagement where the company's stakeholders were requesting that this additional information be produced.

Only the very best candidates were able to expand their answers and maximise their technical marks by recognising that the sustainability report might also form part of the other information over which the auditor has responsibilities in line with the requirements of ISA 720 *The Auditor's Responsibilities Relating to Other Information*.

Overall professional skills marks
In addition to the professional skill marks described within the different sections of the question, four marks were available for communication overall. These marks were awarded for the use of a report header and introduction, presentation and relevance of answer and clarity of explanations. This session it continued to be disappointing that a number of candidates did not present their answer in a suitable format and therefore were not able to score all the communication marks.

Section B
Question 2 – Kerr

Kerr Co was a 25-mark question focussed on evaluating the matters to be considered by Earps & Co when determining whether to accept a due diligence engagement for an existing audit client. The question also focussed on the work which would be necessary on a key aspect of the target company's financial information if the engagement were to be accepted.

> It is 1 July 20X5. You are a manager in the transaction advisory department of Earps & Co, a large, global firm of Chartered Certified Accountants. Your firm has offices in over 100 countries and has a broad range of clients, including a number of large, well-known multinational companies.
>
> You have been contacted about one of the audit firm's existing key clients, Kerr Co, a large unlisted company which manufactures cars.

There were two exhibits:

1.	Kerr Co – information relating to the potential acquisition of Bright Co, a company based in Farland.
2.	Bright Co – warranty information in respect of Bright Co.

Overall, candidates' performance in this question was disappointing. Answers to requirement (a) were generally more structured and detailed, although many did not cover enough points to obtain a pass mark. Answers to requirement (b) were weak overall with many candidates misinterpreting the information provided in relation to (b)(i) and many providing only a couple of high level, and unclear, due diligence procedures in response to (b)(ii). As such, many candidates were also unable to demonstrate the professional skills that were examined in the question of professional scepticism and judgement, analysis and evaluation and commercial acumen.

Requirement (a) – 10 marks

> Using the information in Exhibit 1:
>
> **(a) Discuss the ethical and professional matters which should be considered by Earps & Co prior to tendering for the due diligence assignment.**
>
> (10 marks)

Requirement (a) asked candidates to discuss the ethical and professional matters to be considered when determining whether to accept the due diligence assignment. This requirement should have been very familiar to candidates as acceptance of engagements is a common topic at AAA. Candidates were directed to use Exhibit 1, and it was pleasing to see that the majority of answers reflected this guidance. Overall however, answers to this requirement were mixed with many candidates not evaluating an appropriate number of areas with sufficient depth to pass this requirement.

Many candidates did not read the scenario carefully and spent time examining whether the firm, Earps & Co, had the competence to conduct a due diligence assignment, even though the scenario clearly stated that the firm had a specialised transaction advisory team. Candidates also wasted time discussing that this work would need to be performed by a team separate to the audit team, which again was clearly stated in the scenario. A number of candidates also demonstrated a lack of commercial awareness by suggesting that the four-week window of exclusivity which was being offered to Kerr Co in which to perform the due diligence work must be a sign that fraud was occurring at Kerr Co or the target company, Bright Co.

It was pleasing to see that a high proportion of answers tackled some of the specific professional issues which were present within the scenario, such as the impact of the extremely short timescale which was being placed on the due diligence assignment and the impact that this might have on the firm's ability to conduct a quality engagement. A significant number of answers also considered the impact of the foreign location of the target company. Better answers considered the ultimate users of the due diligence report and that engagement risk might be increased due to the reliance which might be placed on the report by the providers of finance. However, a significant minority of candidates wasted time discussing the level of assurance which might be provided, or the scope of the work which might be involved, despite the fact that the scenario clearly stated it would be performed as an 'agreed upon procedures' assignment. The strongest answers also went onto to assess the confidentiality risk which might be present as a result of the period of exclusivity, and that the firm would have to ensure that appropriate safeguards were adopted to protect sensitive information. Only the very best answers were able to comment on the possible limited information which might be available on which to perform the due diligence work. This is due to the tight timeframe to perform the engagement and the potential impact this might have on other commitments and clients of Earps & Co. Candidates who assessed these wider impacts were awarded professional skills marks for demonstrating commercial acumen.

The ethical issues present in the scenario were less well tacked, with many candidates completely overlooking the possible familiarity threat and risk of assuming management responsibilities. While many candidates identified that there was a possible self-review threat from providing both the audit and due diligence work, this was often explained from the wrong perspective or candidates simply stated that the auditor would be reviewing their own work. This explanation is not detailed enough to demonstrate that candidates clearly understand how the self-review threat arises or the implications for the firm (eg if the acquisition is successful the work undertaken surrounding the due diligence may be reviewed as part of the audit, resulting in the audit team placing too much reliance on the work). Better answers recognised that this risk was increased by the suggestion that the existing audit manager could support the due diligence team, and credit was awarded where candidates stated that the audit manager must be excluded from the engagement.

A number of candidates suggested that there were significant self-interest or advocacy threats in relation to the engagement. The fact that the non-assurance engagement will earn Earps & Co a fee is not sufficient to suggest that there is a self-interest threat as, of course, income must be generated for all work performed. Further, given the detail and context provided in the scenario, there was little to suggest that the firm may be at risk of representing or advocating for Kerr Co with the providers of finance. Similar to the comments made in relation to the Section A question above, candidates should focus on the detail they are provided with to evaluate the ethical threats, rather than choosing to speculate about issues which might arise. Gaining sufficient exposure to different types of ethical threats through extensive question practice will better allow candidates to connect the relevant information which is present within a scenario with the relevant types of threats and their implications.

Requirement (b) – 10 marks

Using the information in Exhibit 2:

(b)(i) Discuss why part of the due diligence investigation would focus on the warranty obligations of Bright Co.

(4 marks)

(b)(ii) Recommend the due diligence procedures which should be performed in relation to the warranty obligations of Bright Co.

(6 marks)

Requirement (b) was generally poorly attempted, and it was disappointing to note that many candidates clearly did not understand the main objective of a due diligence engagement with many answering both parts of the requirement from an audit perspective.

Requirement (b)(i) was poorly attempted by the majority of candidates, with many either not producing enough points to score well, misunderstanding the purpose of the requirement or misinterpreting the information provided in the scenario. Candidates were told that the target company, Bright Co, offered seven-year warranty with their vehicles and that this was not accounted for as a separate performance obligation under IFRS 15. This information was aimed at informing candidates about the type of warranty which was being offered by Bright Co and that this should be accounted for in line with the requirements of IAS 37. This should have allowed candidates to understand that the seven-year assurance type warranty which was sold with Bright Co's vehicles was likely to give rise to a very significant liability in the company's financial statements. A focus of any due diligence assignment would be to understand how such a significant liability was determined and valued, as well as ensuring it was not understated. Unfortunately, many candidates demonstrated a lack of accounting knowledge and focussed on challenging the accounting treatment which was being applied by Bright Co or inappropriately challenging the commercial viability of offering such a long warranty.

Therefore, answers which focussed purely on stating the accounting rules included in IFRS 15 when warranties do meet the criteria to be treated as a separate performance obligation, scored minimal to no credit. Aside from this being the wrong interpretation of the information provided, this does not answer the requirement as set. Providing the accounting rules or guidelines does not answer a requirement which asks **why** the due diligence assignment would focus on this area of Bright Co's financial information. Candidates who were able to question the subjectivity and difficulty in setting assumptions for the warranty provision, as well as the fact that the length of the warranty period made those assumptions more difficult, were awarded technical and professional skill marks for displaying understanding of the purpose of due diligence and applying professional scepticism. The best answers were those which were able to also connect the risk of manipulation by the management of Bright Co to amend the warranty liability in order to maximise the selling price, which might be achieved on the sale of the company.

Requirement (b)(ii) was better attempted, but many candidates struggled to provide a sufficient number of targeted due diligence procedures in order to score enough technical marks to pass the requirement. Many answers provided procedures which would be more suitable for an audit engagement, such as review the disclosure included within the financial statements or obtaining a written representation from management confirming that the provision was complete. These types of procedures scored no credit as they are not appropriate in the context of due diligence work. Many candidates also continued to focus on challenging the accounting treatment of the warranty provision, providing procedures aimed solely at assessing Bright Co's revenue recognition or reviewing board minutes for the approval of such a long warranty period. Again, these types of procedures scored no credit as they do not answer the requirement.

Better answers were those which focussed on reviewing the warranty agreement to gain understanding of the terms of the warranty. Further credit was given to those who assessed the extent of issues which would be covered in order to better understand the assumptions which should be used in the determination of the liability. Strong answers also included analytical procedures aimed at understanding recent trends or changes in the liability as well as whether specific car models or periods of time gave rise to higher warranty obligations. Candidates who provided focussed due diligence procedures targeting the key risk areas of the warranty provision were also awarded the associated professional skill mark.

Question 3 – Phoenix

It is 1 July 20X5. You are an audit manager in Reeves & Co, a firm of Chartered Certified Accountants. You are responsible for the audit of Phoenix Co, a listed company which operates a digital media streaming service. The audit of Phoenix Co's financial statements for the year ended 31 March 20X5 is at the completion stage. Based on the review of the audit working papers, several issues have been included in the Report to Those Charged with Governance. You are now considering which of these should also be disclosed as a Key Audit Matter (KAM).

There were two exhibits:

1.	Phoenix Co – matters to be included in the Report to Those Charged with Governance of Phoenix Co
2.	Request from the finance director – details of a request to provide an additional service.

This 25-mark question was set at the completion and reporting stage of the audit of Phoenix Co with a focus on the purpose and content of the key audit matters (KAM) section of the auditor's report. This question provided details of matters which had been included in the Report to Those Charged with Governance (TCWG) of Phoenix Co and candidates were asked to determine if such matters were also a KAM and if so, what should be included in the KAM section of the auditor's report.

The question then moved on in time and candidates were presented with some additional information in the form of an email asking the firm to provide an additional service following the completion of the audit.

Professional skill marks were available for analysis and evaluation and professional scepticism and judgement.

Requirement (a) – 5 marks

(a) Explain the purpose and content of the Key Audit Matters (KAM) section of the auditor's report and how it meets the needs of the users of the auditor's report. Note: You do not need to refer to any exhibit to answer this requirement. (5 marks)

Requirement (a) asked candidates to demonstrate their understanding of the purpose and content of the KAM section of the auditor's report and to consider how the addition of the KAM section helps to meet the needs of the users. This was a standalone requirement and did not require the candidates to use any of the exhibits provided with the question. Answers to this requirement were mixed.

A sizeable number of candidates ignored the instruction from the examining team to not refer to any exhibit and tried to make their answer relevant to Phoenix Co. Candidates who took this approach were not able to maximise their marks across requirements (a) and (b) often repeating the same points. Candidates are reminded that a key part of appropriate exam technique is to ensure that they follow and adhere to all guidance and instructions provided.

Weak answers displayed little to no understanding of the purpose of KAM or the matters which would be included in the KAM section. Some answers included details of where the KAM would be positioned in the auditor's report, which did not answer the requirement.

Most answers were able to discuss that the KAM section is mandatory for listed companies, that it covers matters which the auditor has determined to be of the most significance during the audit and the KAM section should provide details of how the matter has been addressed during the audit. Disappointingly few candidates demonstrated knowledge that the KAM are selected from matters which have been reported to TCWG, or that the auditor is not providing a separate opinion on these matters.

Only strong answers were able to answer the part of the requirement related to meeting the needs of the users, focussing on the increased transparency it provides over the audit process and helping to improve challenge over management judgements and, therefore, audit quality. Many answers incorrectly suggested that through KAM the auditor was aiming to help investors make better financial decisions showing a misunderstanding of the responsibilities of the auditor.

Requirement (b) – 8 marks

Using Exhibit 1: **(b) For each of the matters included in the Report to Those Charged with Governance:** **(i) Justify whether the matter should also be included in the KAM section of the auditor's report; and** **(ii) Where appropriate, briefly describe the specific features of the disclosure which should be made.** Note: You are NOT required to draft the KAM section of the auditor's report. (8 marks)

Requirement (b) asked candidates to consider each of the matters set out in Exhibit 1 and justify whether it should be included as a KAM and what disclosure should be included in the KAM section as a result. Answers to this requirement were mixed.

There were some very strong answers, often scoring close to full technical marks, which displayed clear understanding of the requirements of ISA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*, and which confidently concluded and justified the appropriate treatment of each matter. However, a significant number of candidates were unable to apply their knowledge to the specifics of the question or continued to display a lack of knowledge over this key auditing standard. Completion and reporting questions will appear in every exam session and candidates must ensure that they have an appropriate level of knowledge of the suite of reporting ISAs. One of the key skills being tested by this requirement is whether candidates can apply their knowledge of ISA 701 in a practical context and, unfortunately, many answers fell short of this standard.

In relation to the point regarding rotation of the audit partner, most answers were able to conclude that the matter should not being included in KAM, but then failed to provide adequate justification. A high proportion of candidates wasted time discussing the rotation rules, included within the IESBA Code, that the audit partner should be rotated after seven years (five years in the UK, IRL and SGP versions of the exam) despite the fact that the scenario clearly indicated that this safeguard was correctly being put in place. In line with ISA 260 *Communication with Those Charged with Governance*, for listed companies the auditor is required to communicate any threats to independence which have been identified and the safeguards applied to mitigate those threats. Hence it is appropriate for this matter to be included in the Report to TCWG, but it does not constitute a KAM as it is not an area of significant auditor judgement.

The matter in relation to revenue recognition was, again, an area where many could correctly conclude that this should be included in KAM due to its identification as an area of high risk, and that it required significant auditor attention. A good number of answers were also able to discuss the need for disclosure of why revenue recognition would meet the definition of a KAM and that detail should be provided regarding the approach to the risk and procedures, which were performed during the audit, such as reference to the internal expert team. Some candidates, however, wasted time discussing the accounting requirements of IFRS 15 which were not relevant to the requirement. Fewer answers referred to the need for reference to the related disclosures within the financial statements or made adequate reference to the detail in the scenario about the complexity of the contracts which would have been a primary driver of the level of risk over this area of the financial statements.

Reponses to the matter regarding Phoenix Co's intangible assets and amortisation were similar in that many correctly concluded it should be included in KAM, but were light on the justification as to why or what disclosure should be made as a result. As stated before, answers which made use of the detail in the scenario and referred to the significant judgements being made by management and the auditor's use of tests of controls produced more tailored answers and were able to score both higher technical and professional skill marks.

Requirement (c) – 7 marks

It is now 1 September 20X5. The matters described in Exhibit 1 have been resolved and the financial statements for the year ended 31 March 20X5 have been issued.

Using Exhibit 2:

(c) Evaluate the professional and ethical matters which should be considered by Reeves & Co regarding the finance director's request.

(7 marks)

Answers to requirement (c) were generally satisfactory. Candidates were moved forward in time and asked to consider the ethical and professional issues arising from a request and comments made by the finance director.

The finance director of Phoenix Co was requesting that the audit partner accompany them to a meeting with funding providers to answer questions on the last two sets of financial statements. This was partly due to the fact that the finance director was relatively new to the company and, therefore, felt that the audit firm would be able to provide more informed answers. Most answers were able to adequately evaluate the connected advocacy threat, explaining that attendance at the meeting could be perceived as the firm supporting Phoenix Co's application for funding. Stronger answers were also able to discuss the possibility that attendance at the meeting could result in Reeves & Co assuming management responsibilities as providing answers or clarifications regarding the content of the company's financial statements is the remit of management. Most candidates were therefore also able to correctly conclude that due to the existence of these threats, the request to attend the meeting should be rejected.

It was notable that few candidates considered the possibility of a familiarity threat arising as a result of this request. The newly appointed finance director was making a personal request of the audit partner to attend the meeting and support them due to their lack of experience and time with the company. Such a request may allow for a close working relationship to develop, ultimately affecting the independence of the firm.

In this question, it was pleasing to see that a high proportion of candidates recognised the suggestion of a contingent fee and adequately explained the self-interest threat which could arise as a result.

In terms of the related professional issues, the majority of candidates were able to comment on how the audit was completed in the same timeframe, but with less staff and this might have increased the level of audit risk and the chances of undiscovered material misstatements. Fewer answers picked up on the risk connected to the fact that the finance director had only been in the role for six months and would have been appointed shortly after the end of the most recent financial year. This may have resulted in inappropriate judgements being applied or answers provided, especially given their lack of experience and confidence in answering questions in the meeting. Overall, these issues suggested that there may be some concerns over the quality of the audit which had recently been completed.

Overall

The performance of candidates in these questions is broadly in line with past sessions. There continues to be a gap between candidates capable of demonstrating audit competence through strong application of knowledge and concepts to practical scenarios, and those who approach the examination as a factual exercise and fail to tailor their answers to the scenarios or do not show professional scepticism or commercial awareness. Many candidates also continue to show a lack of what should be assumed knowledge for materiality, ethics and auditor reporting and continue to produce answers of a standard below what is expected at AAA level.

Practice of past questions will aid candidates in determining their knowledge gaps and give practice at applying their knowledge to the given scenarios. It is essential that candidates analyse their answers in comparison to the scenario specific explanations given in the model answers to understand the level of analysis which is needed in the AAA exam. This question practice needs to also be based on a good knowledge of the syllabus and must build upon both the Applied Skills level audit and financial reporting examinations and the Strategic Business Reporting (SBR) syllabus. Candidates are encouraged to ensure that their assumed knowledge in both areas is at an appropriate level before commencing their studies towards the AAA exam.

Candidates are encouraged to develop a wider appreciation of the significance of risks by reviewing published auditor's reports of listed companies where the auditor produces a key audit matters section. This will allow candidates to see real world explanations by auditors of why something was a specific risk to a specific client. There are also a significant number of accessible resources available which can help candidates put their studies at AAA into a more practical context. Resources can be found both on the ACCA website and also through the IAASB and can help candidates better understand some of the practical challenges auditor's face.

The examining team also uses the list of examinable documents to try and highlight to candidates the resources which are being produced which may be beneficial to look at in more detail in order to supplement their studies, for example the IAASB or FRC discussion papers and guidance documents.

Information and guidance on the introduction of professional skills marks for AAA is available as part of the study resources on the ACCA website.