



Think Ahead

Foundations in Auditing (FAU) December 2023 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 two-hour examination was divided into two sections.

Section A consisted of fifteen multiple choice questions (MCQs) each worth 2 marks. Each MCQ had four possible answers, of which only one was correct. Section A was weighted at 30% of the total marks and marked by computer.

Section B consisted of eight questions: two each worth 15 marks, two each worth 10 marks, and four each worth 5 marks. Section B was weighted at 70% of the total marks and marked by a specialist team of markers.

All questions in this examination were compulsory.

The MCQs in Section A achieved the objective of testing candidates' knowledge of a broad range of topics in the syllabus. The performance of candidates across the range of questions in this section was generally very good and it was particularly pleasing to note high pass rates on the majority of the questions, many of which were on core areas of the syllabus. It was also apparent that the average amount of time taken to answer each of the fifteen questions was considerably less than the target time. It was noticeable that many candidates fared better with knowledge-based questions compared to those which were application based. While questions in the latter category do tend to be more challenging, all questions were considered to be fair for reasonably well-prepared candidates. As is often the case in FAU, the primary reason for candidates' inability to answer more questions correctly appears to have been a lack of adequate preparation and, on occasion, not answering questions in accordance with the stated requirements.

Specific Comments

Section A

As indicated above, the overall standard of responses was very good. However, in common with previous sessions, candidates' failure to answer questions correctly appears to have been due to inadequate preparation and coverage of the syllabus. The average time taken to answer each question was well within the 2.4 minutes allowed for each question, assuming 1.2 minutes per mark for the whole paper.

A commonly held perception amongst some students is that MCQ questions are easier than essay style questions, because "*answers are given to you*". In reality this is often not the case. MCQ questions are often every bit as challenging as essay style questions, sometimes more so. As with essay style questions, the way to improve exam performance is to learn the material and practice answering questions to test knowledge and understanding.

Candidates should also bear in mind never to leave any question unanswered, on the basis that to do so means there is no chance of obtaining the marks available. Instead,

one should consider all options carefully and make an educated guess as to the correct answer.

Set out below are four examples of questions in Section A which were not well-answered by the majority of candidates, together with the solution to each and explanatory notes.

Example 1

In response to the key question "Can liabilities be understated?" which of the following procedures in the purchases and trade payables area of a company should provide positive assurance to the auditor?

- A. Purchase ledger balances are regularly reconciled to supplier statements, and any differences are followed up to resolution
- B. Goods received are inspected for quantity and quality and checked to purchase orders, prior to the issue of goods received notes
- C. Purchase invoices are matched to goods received notes before being posted to the purchase and general ledgers.
- D. All purchase invoices are authorised by a responsible manager before being posted to the purchase and general ledgers

A is the correct option – this would provide the assurance needed.

Option B would only provide assurance that goods received and accepted were ordered. Procedure C would only provide assurance that goods were received for purchase invoices posted. Procedure D would only provide assurance that purchase invoices are authorised prior to being posted.

Option C was a very popular choice. However, the specific assurance provided here relates to overstatement, rather than understatement.

Example 2

Which of the following is TRUE with regard to the arrangements for audit testing of a client's accounts receivable balances using an accounts receivable confirmation (circularisation).

- A. The audit client should select the sample of accounts receivable balances to be confirmed
- B. The confirmation request letter should be on the auditor's headed paper and signed by the auditor
- C. The auditor should send the confirmation letter requests
- D. The replies to the confirmation request letters should be sent to the client OR to the auditor, depending on the strength of the client's internal control

C is the correct option. It is true that the auditor should control this aspect of the process, to prevent client intervention with a view to confirming incorrect trade receivables balances.

Statement A is false, the auditor should select the sample. Statement B is false as the request should be on the client's headed paper, signed by the client. Statement D is false, the replies should always be sent directly to the auditor.

Option A was a popular choice. However, if the audit client selected the sample for confirmation, they may also purposefully ignore accounts fraudulently misrepresented in accounts receivable for confirmation, including non-existent customer accounts.

Example 3

Which of the following general IT controls would help to ensure the continuity of operations of a computer-based accounting system?

- (1) Off-site storage of copies of data files
- (2) Password protection
- (3) Maintenance agreements

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

B is the correct option as both controls would help to ensure the continuity of operations. The controls given in both A and D would help ensure the continuity of operations. Option C was a popular choice. However, the objective of password protection is to prevent unauthorised changes to programs and data files and does not help ensure continuity of operations.

Example 4

Which of the following matters MUST be included in written representations requested by the auditor, from a company's directors, on an audit engagement?

- (1) They have provided the auditor with all relevant information and access as agreed in the terms of the audit engagement.
- (2) All account balances reflected in the financial statements are complete and accurate and no account balances have been omitted.
- (3) All transactions have been recorded and are reflected in the financial statements.

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

C is the correct option. Per ISA 580 *Written Representations*, the auditor is required to request the directors to provide written representations confirming the matters at 1 and 3. There is no requirement within ISA 580 for the auditor to request the directors to provide written representations confirming that all account balances reflected in the financial statements are complete and accurate and no account balances have been omitted. Option D was a popular choice. However, while directors are required to provide written confirmation that all transactions have been recorded and are reflected in the financial statements, there is no requirement to provide similar confirmation about the accuracy of account balances.

Performance on each of the above questions varied, with many candidates failing to choose the correct option for each. General IT controls, as in Example 3 above, is typical of an area in this exam where the pass rate for the question was relatively low. This is possibly because candidates paid insufficient attention to the area when preparing for the exam and guessed incorrectly when choosing an option. Candidates are encouraged to attempt each question and are reminded to ensure they should cover every area of the syllabus when preparing for the exam, such that if they are unsure between options they make will be able to make an 'educated' guess.

Section B

For Section B it was pleasing that some candidates were well prepared for the exam. However, it was apparent that many candidates were insufficiently prepared to answer questions in this section. Common weaknesses in answers to all questions in Section B were:

- Answers which did not adhere to question requirements, for example, providing only one reason and no explanation in response to a requirement to identify and explain two reasons as to why the area of inventory in a large company with remote operating locations has high inherent risk.
- Answers which demonstrated a lack of understanding of the audit risk model, confusion as to the relationship between inherent risk, control risk and detection risk; and the effect on materiality levels.
- Answers which were simply far too brief, giving markers very limited scope to award anything other than a minimal mark.
- Limited or overly simplistic explanations and commentary.
- Answer content which was often longwinded but bearing little relevance to question requirements.
- Poor structuring of answers and muddled points.

- Answers which addressed generic issues in the syllabus area to which the question related, but which weren't pertinent to the issues raised in the question. For example, on a question about an auditor's review and investigation of subsequent events, the majority of candidates wrote extensively about irrelevant points, with few correctly commenting specifically about adjusting and non-adjusting events and procedures forming part of the review.

The long-form questions

The 10-mark question about the fundamental principles of ACCA's Code of Ethics and Conduct was answered well by candidates. A significant number of submissions answering the other 10-mark question, about audit evidence, and the 15-mark question about the internal control exercised over a purchases and trade payables system, demonstrated weak levels of knowledge and understanding. This was disappointing given the straightforward nature of each question's content and requirements. The pass rate for the other 15-mark question was exceptionally low, and to aid understanding as to what pass standard answers needed to contain; the question, suggested solution, commentary and guidance notes are set out below.

Question

Georgian Co is a sports equipment retailer and has been an audit client of your firm for several years. When formulating the strategy for the audit of the company's financial statements for the year ended 31 July 20X5, the audit engagement partner considered a range of matters including the following:

- (i) With effect from 1 February 20X5, Georgian Co made substantial changes to its system of internal control, including changes to the information system relevant to the preparation of the company's financial statements. These included replacing the accounting software in use with a more advanced package offering faster processing of data and more comprehensive reporting features. Also, following the retirement of several accounts department staff on 31 January 20X5, the department was reorganised and various responsibilities and duties were reallocated amongst existing and new staff members.
- (ii) Consistent with declining performance levels in the previous three years, the company reported an operating loss for the period, resulting in cash flow issues and the need for extra loan finance, and a substantial overdraft at the year end. Georgian Co's directors have confirmed that trading conditions in the sports equipment market continued to be very challenging, but they are confident that the company will return to profit and that there are no going concern problems for the company. Profit and cash flow forecasts prepared by the directors support this view, indicating a strong performance for the year ending 31 July 20X6, and the following three years.

Requirements:

- (a) State the purpose of each of the following:
- (i) *Audit strategy*
 - (ii) *Audit plan* (4 marks)
- (b) Explain how each of the two matters considered by the audit engagement partner should have impacted on the strategy for the audit of Georgian Co's financial statements for the year ended 31 July 20X5. For each matter, your explanation should identify specific concerns the partner may have had about audit risk. (8 marks)
- (c) State two matters the audit engagement partner should have considered when choosing the audit team and the allocation of work to team members for the audit of Georgian Co's financial statements for the year ended 31 July 20X5. (3 marks)

(Total: 15 marks)

Suggested solution:

- (a) Per ISA300 *Planning an Audit of Financial Statements*:
- (i) The purpose of the audit strategy is to set the scope, timing and direction of the audit and guide the development of the audit plan. (2 marks)
 - (ii) The purpose of the audit plan is to describe the nature, timing and extent of risk assessment procedures, audit procedures at the assertion level and other audit procedures to be performed by engagement team members to achieve the audit objectives (2 marks)
- (b) That a new accounting software programme was in use from 1 February 20X5, along with the reorganisation of and reallocation of responsibilities and duties from that date, means that the system of internal control exercised over Georgian Co's accounting and financial reporting was significantly different for the period 1 February 20X5 to 31 July 20X5 as compared to the first six months of the financial year. Consequently, the audit strategy would need to recognise that the risk of material misstatement (comprising inherent risk and control risk) would need to be assessed separately for each period, as would detection risk - in order to achieve and acceptable level of audit risk. The strategy should have recognised the requirements for test data and audit software to carry out tests of controls and substantive procedures respectively, and the need to consider the effect of the reorganisation of the accounts department and the reallocation of duties and responsibilities on the information system and communication. (4 marks)

The strategy should have ensured adequate focus on the need to evaluate the appropriateness of the directors' use of the going concern basis of accounting in the preparation of Georgian Co's financial statements. Declining performance levels in challenging market conditions leading to a reported operating loss, cash flow issues and the need for loan finance and a substantial bank overdraft at the year end all increase audit risk in this regard. Consequently, the audit strategy should have focused on the requirement to gain sufficient appropriate audit evidence to obtain assurance about Georgian Co's going concern status.

Appropriate focus on the robustness of the directors' review of the company's position and on profit and cash flow forecasts prepared would be crucial in this regard as would be ensuring the thoroughness of the firm's review of events after the period end and an adequate degree of professional scepticism when forming judgement as to Georgian Co's ability to continue as a going concern.

(4 marks)

- (c) The audit engagement partner should have considered the following matters:
- The competence of individual team members, taking account of their knowledge and skills.
 - The requirement to have strong management and supervision of the audit work to be carried out, by individuals familiar with the company's audit.
 - The requirement for particular expertise in the use of automated tools and techniques.
 - The need to avoid threats to the independence and objectivity of audit team members.
 - The requirement for particular experience in the audit of going concern issues.
 - The need to complete the audit work in line with the due date for the issue of the auditor's report.

3 marks (2 matters required)

Commentary and guidance notes:

- (a) Better responses were based around the ISA 300 definitions of an audit strategy and an audit plan. Answers explaining the nature of, and example content of each and displaying cogent understanding, were also acceptable. Candidates obtaining fewer than 2 of the 4 marks available often confused the plan and strategy content with each other, and a significant number wrote rather longwinded and inaccurate commentary about each.
- (b) To obtain a pass mark, candidates needed to recognise the significance of the change in the company's internal control system part way during the financial year, the consequences of this for the auditor and the obvious impact on the audit strategy. Per the suggested solution, there are effectively two periods for which the auditor would need to carry out separate assessments of the risk of material misstatement.

To obtain additional marks for this point, answers needed to make reference to the consideration of inherent risk, control risk and detection risk, and the need to use automated tools and techniques in order to obtain assurance about the company's new accounting software package. The majority of candidates scored only a small fraction of the marks available for this part of the requirement, because they did not mention any of the above points in their answers.

Candidates needed to recognise that the auditor should be aware of the increased risk that the company may not be a going concern, and that the audit strategy needed to have sufficient focus on this. Consequently, the strategy should have set out the requirement to exercise appropriate levels of professional scepticism when reviewing the directors' representations about the going concern status of the company, and when carrying out testing of the profit and cash flow forecasts. Similarly, candidates' responses should have referenced the need for the strategy to recognise the importance of carrying out a thorough review of subsequent events, in the knowledge that the company may not be a going concern. While the majority of candidates obtained 1 mark for recognising the increased going concern risk, only a minority gained any marks for commentary about the need to exercise professional scepticism, to carry out audit tests on the profit and cash flow forecasts and fewer appeared to be unaware of the need to carry out a review of subsequent events. Consequently, the average mark for this part of the requirement was low.

- (c) Candidates needed to state two matters to be considered when selecting the audit team and allocating work. Candidates often only stated one or two matters in an abbreviated form, for example writing the word competence on one line and the word supervision on another. This form of response is worthy of only $\frac{1}{2}$ a mark. Other reasons for not scoring more marks included repetition of the same point, for example, maintaining independence of the audit team and maintaining its objectivity.

The short-form questions

As indicated above, the overall performance on a question about subsequent events was particularly weak. As to the standard of responses to a question about inventory, it is apparent that the majority of candidates need to improve their knowledge and understanding of this topic. The questions on client screening and the auditor's opinion were answered to a pass standard by a small majority of candidates but there was room for considerable improvement in most of the pass standard submissions.

Conclusion

Auditing is a highly technical subject and it is generally accepted that auditing students, at any level, need to apply themselves diligently to a carefully programmed course of study and revision to achieve success in the assessment process. There is no easy route to passing the FAU exam. It is broad ranging and to achieve success candidates need to ensure they have sound knowledge of the core topics in the syllabus, and a basic appreciation of the application of auditing techniques and procedures. They also need to ensure they have good exam technique, something that is best developed by attempting

to write full answers to a broad range of questions in self-imposed, time constrained exam conditions.