



Foundations in Audit (FAU) December 2020 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 examination paper comprised two sections and all questions in each section were compulsory. All 15 questions in Section A were multi-choice questions (MCQs), each worth two marks, carrying a total of 30 marks. Section B comprised eight questions with two questions each worth 15 marks, two carrying ten marks and four carrying five marks each. These knowledge and scenario based questions tested candidates' ability to identify, explain, and apply relevant knowledge and auditing techniques.

The MCQs are set to test candidates' knowledge of a broad range of topics in the syllabus. It was encouraging that the overwhelming majority of the 15 questions were answered correctly by most candidates but there were many incorrect answers submitted to several straightforward questions on core topics included in the syllabus.

The overall performance was reasonably strong with candidates generally performing better with Section A questions than those in Section B. There was a significant number of unsatisfactory submissions, indicating some candidates had not heeded previous guidance provided - emphasising the need to have a solid knowledge and understanding of all core areas of the syllabus, to enable them to have a realistic chance of achieving a satisfactory score for the section.

Across the range of questions in Section B, there were many sound answers, with a significant proportion of candidates performing well on at least two of the five-mark questions. Balanced against this, a number of submissions were unsatisfactory across the majority of questions - again (as for Section A) indicating a lack of overall preparation for the exam by a significant number of candidates. Common weaknesses in responses to Section B questions were:-

- Answers which were generic and confused and did not focus on the requirement.
- Answers which bore little or no relevance to the scenario and requirement.
- Answers which were inadequately structured and contained muddled and incorrect points.
- Answers which were simply too brief, containing limited and overly simplistic explanations and commentary.
- Answers which addressed issues in the syllabus area to which the question related but were not pertinent to the issues raised in the question.

Auditing is a technical subject, and it's generally accepted that candidates, 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, at the very least, they have sound knowledge of all the core topics in the syllabus and a basic appreciation of the application of auditing techniques and procedures.

Specific Comments

Section A

Candidate's performance accentuated the point that candidates who focussed on learning the range of syllabus topics and practice exam technique normally perform strongly in this section. Conversely, those who do not adopt this approach have difficulties, answering few of the questions correctly. Average times taken to answer were 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 candidates is that MCQs are easier than essay style questions because "*answers are given to you*". This is often not the case and MCQs 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, learn, learn the material and practice, practice, practice answering questions to test knowledge and the ability to apply the knowledge to answer questions correctly. The remedy to improving on a less than satisfactory performance this time is to adopt this approach next time.

The least well answered question in this section was:

Example 1

Which of the following is NOT an example of a matter which should be considered when determining whether a deficiency in internal control is a significant deficiency?

- A The volume of activity that has occurred or could occur
- B The interaction of the deficiency with other deficiencies in internal control
- C The availability of resources to prevent, detect and correct the deficiency
- D The financial statement amounts exposed to the deficiency

The correct answer is option C. The availability of resources to prevent, detect and correct deficiencies is a relevant consideration in determining how they may be resolved, but not in determining whether they are significant. The matters at A, B and D are relevant to this determination.

Another question in this section which a high number of candidates answered incorrectly was:

Example 2

A company sells two products and there has been a significant decrease in its reported gross margin compared to the previous year.

Which of the following reasons given by management to explain the increase, could be valid?

- (1) A significant change in the sales mix volumes of the two products.
- (2) A change of the supplier from which it purchases its products.
- (3) Significant write-offs of impaired trade receivables balances.

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

The correct answer is option B. Each of the matters stated at 1 and 2 are drivers of gross margin. If the products have different gross margins, then it is probable that a change in sales mix volumes would lead to a change in the overall gross margin achieved. Similarly, where a change in a supplier results in the company paying a higher price for its purchases, this will have the effect of reducing the overall gross margin. Consequently, explanations centred on these matters would be valid. The extent of impaired debts does not affect gross margin.

Finally, a straightforward question about materiality - answered incorrectly by a particularly high number of candidates was:

Example 3

Which of the following is NOT generally recognised as an appropriate quantitative benchmark for the assessment of materiality for the financial statements as a whole?

- A % of total assets
- B % of sales (revenue)
- C % of profit before tax
- D % of total costs

The correct answer is option D. With the exception of total costs, all of the key indicators stated are generally recognised as appropriate benchmarks for the assessment of materiality.

Candidates need to possess a reasonably sound knowledge of the concept of materiality in the context of an audit of a company's financial statements, and the

benchmarks used for determining it. Materiality is a key consideration for the external auditor so it is likely to feature regularly in the FAU exam.

Section B

The section contained a broad range of knowledge and application based essay and short commentary type questions. The overall performance by candidates generally was satisfactory, although increased focus is required on topics specifically linked to auditing in a computer-based environment and with regard to the objective and nature of substantive procedures generally. A significant number of candidates did not demonstrate sound levels of basic knowledge and understanding in core areas of the syllabus. Dealing with each question in turn:-

Question 16

The question tested candidates' knowledge and application of various aspects of internal control. At part (a) - focussing on two specified components of a company's control environment - a high number of candidates were unable to accurately explain the term 'management's philosophy and operating style' and an overwhelming majority scored only a fraction (if any) of the marks available for explaining the term 'organisational structure'. Many confused organisational structure with assignment of authority and responsibilities, indicating a lack of understanding of control environment as a component of internal control. The answers submitted to the other parts of the question did not demonstrate understanding of the concept of segregation of duties and also the range of control activities (policies and procedures) which a company may implement to reduce the risk of impaired debt when making sales on credit terms. As previously indicated, in every FAU exam a significant proportion of the marks will be devoted to testing knowledge an application of aspects of internal control.

Question 17

This question – focussed on going concern and the auditor's approach when seeking assurance about going concern status - was problematic for a high proportion of candidates. Three marks were available for explaining the meaning of professional scepticism and the need to apply it on an audit engagement. Although most candidates were able to do the former, many were unable to state a valid reason as to why it is important for auditors to adopt such an attitude on an audit engagement.

The scenario for the question depicted a director-controlled company in financial distress, with several financial indicators which could cast doubt on its ability to continue as a going concern. A clearly stated requirement of the question was to explain why the company's auditor should be sceptical about the directors' going concern representations. Another clearly stated requirement was for candidates to list three examples of operating indicators which may cast significant doubt on a company's going concern status. In context, both of these requirements offered candidates the opportunity to obtain relatively easy marks on an uncomplicated topic. However, many missed the opportunity because they did not follow the requirements and made no reference to the subject company's precarious financial position and the directors' self-interest when responding to the former requirement and referring only to financial indicators when responding to the latter. From the lack of clear answers to the final requirement - to identify one procedure which should form part of an auditor's going concern tests and

enquiries - it should be an area given more focus during preparation for the exam as students should be prepared for a question testing their knowledge about this.

Given the pertinence of and focus on companies' going concern status in the current global economy, it's important for candidates to be prepared for going concern questions in future exams.

Question 18

Most candidates demonstrated a good understanding of the components of audit risk and the application of the audit risk model on an audit engagement. However, it appeared that a significant number had unsatisfactory understanding of what audit risk is, as well as inherent risk in the context of a company's financial statements. Similarly, a high proportion of candidates were unable to link inherent risk factors to audit concerns about specific financial statement assertions. Given the requirements for auditors to adopt a risk-based approach on audit engagements, audit risk will feature regularly in future FAU exams. Therefore, it is crucial for candidates to have a sound understanding of audit risk, the application of the audit risk model and specific audit concerns arising as a consequence of inherent and control risk factors.

Question 19

The requirement - to state three reasons for preparing audit working papers and identify two benefits of using automated working papers - provided candidates the opportunity to obtain ten reasonably straightforward marks. While a number did take the opportunity and scored well, a significant proportion did not answer the question to a satisfactory standard. A contributing factor to this was the number who confused 'automated working' papers with 'standardised working papers' and proceeded to identify benefits of using the latter. As this was not a requirement of the question, no marks could be awarded for these.

Question 20

Many candidates did not answer this question – about auditing in a computer-based environment - to a satisfactory standard because they answered using very generic, often inaccurate non-technical language.

Part (a) offered two marks for explaining the meaning of the term 'General IT controls', and it seemed most candidates were unable to appropriately answer this. An answer along the lines of "*General IT controls are policies and procedures that relate to many applications and support the effective functioning of application controls by helping to ensure the continued operations of information systems*" obtained both marks, and due credit was given to candidates who did answer in such fashion. Future candidates for the exam should note the use of technical terms in the above indicative answer – normally considered an imperative inclusion requirement when answering questions specifically about auditing in a computer-based environment.

Part (b) tested knowledge of the use of 'test data' and 'audit software' when auditing 'through the computer'. Again, to obtain the three marks available, candidates needed to write specifically and meaningfully about these terms, not in a generic fashion. As for part (a) most answers demonstrated surface-level generic understanding of these terms for which a maximum of only 1 mark was awarded.

Question 21

Obtaining assurance about underlying management assertions pertaining to the financial statements (financial statements assertions) is a key requirement if the auditor is to meet the overriding objective of the audit. For this reason, candidates should expect the FAU exam to include questions testing their knowledge and understanding of all the assertions. This question focussed on 'occurrence' and a number of candidates demonstrated familiarity with the term and were able to identify appropriate evidence to obtain assurance about the occurrence of purchase transactions. However, a relatively high number struggled to explain the meaning of occurrence and identify evidence providing assurance about it.

Question 22

A high proportion of candidates struggled with this question about the use of observation as an audit procedure. It was clear that many were unaware of the limitations of its use to obtain assurance about the performance of control procedures, and many confused 'observation' with 'inspection' when identifying specific application of the procedure during an audit engagement. Audit procedures are a popular area for inclusion in the FAU exam and future candidates should ensure a good understanding of their use during the various stages of an audit.

Question 23

This question about the benefits of audit planning and the two categories of substantive procedures (analytical procedures and tests of details) was answered to a satisfactory standard by the majority of candidates. Given the importance of these topics, there is a clear need for all future candidates to have strong levels of knowledge and understanding of them.

Conclusion

Auditing is a highly technical subject, and to pass the FAU exam candidates need to have a sound level of understanding of the range of topics in the FAU syllabus. It is not an easy exam to pass, but questions are set at a level representing a fair challenge to candidates who have prepared diligently, such that they do have a reasonable knowledge of **all** the syllabus areas – particularly of the core areas.

It is important future FAU exam candidates work to a structured study programme over a time period which gives them the opportunity to assimilate and properly understand the learning material. Timing should allow for a period of revision, question practice and at least one mock examination prior to sitting the exam. Those reading this report seeking ways to improve on an unsatisfactory performance in the December 2020 exam should absorb the content and follow the guidance to enhance performance and ensure success next time; and those who are yet to attempt the exam should do the same to help to secure a first-time pass.