



Foundations in Audit (FAU) December 2024 Examiner's report

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

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General Comments

The 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.

Section A

The MCQs achieve the objective of testing candidates' knowledge of a broad range of topics in the syllabus. The performance of candidates across the range of questions was generally good with high pass rates on a significant number of the questions. While the overall standard of responses was encouraging, 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 exam.

A commonly held perception amongst candidates is that MCQ questions are easier than written questions, because answers are provided. In reality, this is often not the case. As is evident from the pass rates for individual questions in this exam, MCQs are often as challenging as written questions, sometimes more so.

Candidates should never leave any question unanswered, on the basis that to do so means there is no chance of obtaining the marks available. Instead, they should consider all options carefully and make an educated guess as to the correct answer if they are unsure. To make such a guess, candidates need to cover every area of the syllabus when preparing for the exam. Also, as there is no pattern to the lettering of the correct options for the questions set, candidates should avoid choosing a particular option based on the pattern of letters to answers already submitted.

When answering the MCQs candidates may quickly dismiss one or two options as incorrect answers, before giving careful consideration to those remaining. This is only a reasonable approach if such dismissal is based on a foundation of sound knowledge.

Set out below are four examples of questions in Section A which were incorrectly answered by the majority of candidates, together with the solution to each and explanatory notes.

Example 1

Which of the following questions would be included in an internal control evaluation questionnaire?

- A. Is the internal audit manager professionally qualified?
- B. Does the company bank cash sales takings on a daily basis?
- C. Are there adequate segregation of duties over the purchases function?
- D. How do you ensure all liabilities are recorded?

D is the correct option. This question would be included in an internal control evaluation questionnaire (ICEQ) because it requires the client to provide details of the controls in place to ensure a specific control objective is addressed.

Options B and C require a simple yes/no answer to ascertain whether a specific control is in place, and as such they would be included in an internal control questionnaire – not in an ICEQ. Similarly, Option A would be included in an internal control questionnaire, because either a yes or no answer will provide clarification about a specific aspect of the company's control environment.

Option C was a popular choice. Segregation of duties is a crucial component of an internal control system. However, the question seeks only to determine whether that particular control exists, it does not seek to confirm that a specified control objective is achieved. As such, it would not be included in an ICEQ.

Example 2

Which of the following balances should be included when performing a trade receivables confirmation?

- (1) Accounts with credit balances
 - (2) Accounts settled by round sum payments
 - (3) Accounts on which there has been no activity during the period under review (dormant accounts)
-
- A. 1 only
 - B. 1 and 2 only
 - C. 2 and 3 only
 - D. 1, 2 and 3

D is the correct option. Confirmation requests should be sent to a sample of accounts in each of these categories.

It would be unusual for a trade receivable account to show a credit balance, and auditors need to be alert to the fact that such balances could be caused by error or fraud.

It is not generally common practice for customers to settle supplier accounts by round sum payments. Where this has occurred, auditors should be aware that they could be due to omissions or errors. For example, customers may have made round sum payments in full settlement of disputed invoiced amounts, leaving the outstanding receivable balances irrecoverable.

It is important to include dormant accounts as confirmation received from a customer about any longstanding balance on their (dormant) account is reliable evidence as to the existence of the balance. Similarly, if the lack of activity shown in the account is due to error or fraud, the confirmation response received is reliable evidence which should guide the auditor as to appropriate follow-up action.

Options A and B were popular choices, with the majority of candidates indicating incorrectly that dormant account balances should not be included in the confirmation.

Example 3

In line with ISA® 210 *Agreeing the Terms of Audit Engagements*, which of the following MUST be included in an audit engagement letter?

- A. The expected form and content of any report to be issued by the auditor
- B. The basis of the computation of the audit fee
- C. Arrangements regarding the planning and performance of the audit, including audit team composition
- D. Any restrictions on the auditor's liability when such possibility exists

A is the correct option. This is a mandatory requirement for inclusion in the letter, as set out in ISA 210.

Options B and C were popular choices, however, whilst the basis of the computation of the audit fee or restrictions on the auditor's liability can be included, there is no requirement to do so. Inclusion is at the discretion of the auditor.

There is no requirement to include details of arrangements regarding the planning and performance of the audit, including the audit team composition, as are unlikely to be known at the acceptance stage of the engagement.

Example 4

Which of the following is a benefit of a company having an external audit?

- A. The shareholders can be confident that their investment in the company is safe
- B. The auditor's report confirms whether or not the company's directors have met the objectives set by the shareholders during the period subject to audit
- C. The audit may detect deficiencies in the company's system of internal control
- D. The company does not require an internal audit function

The correct option is C. The audit may detect deficiencies in the company's system of internal control, as this will be evaluated as part of the auditor's risk assessment procedures. Where significant deficiencies are identified, as per ISA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, auditors must communicate them in writing to those charged with governance on a timely basis.

Options A and B were popular choices. However, the auditor cannot be confident about whether the investment is safe and cannot confirm whether the shareholder's objectives have been met by the directors as this is not within the scope of an external audit.

Option D is incorrect as the objectives of the external auditor and the internal auditor are entirely different. Companies are not required to have an internal audit function. The decision to establish one is that of the board of directors (through an audit committee if there is one) and will depend on various factors including the control environment and the size and complexity of the company's operations.

The pass rate for each of the above questions was disappointingly low compared to all other Section A questions, except for a question on auditor's reports (see Section B commentary below about a short-form question on this topic).

Section B

It was apparent that a significant proportion of candidates were well prepared for these questions. However, it was also apparent that many candidates were insufficiently prepared. Common weaknesses in answers to all questions in Section B were:

- Content which did not adhere to question requirements.
- Content which was simply far too brief or simplistic. This was a recurring issue on all of the questions, but it was particularly prevalent on questions with a requirement with the verb 'explain'. A large proportion of responses to this requirement didn't contain any explanations, or if they did, the explanations were so brief and simplistic that markers had scope to award only a fraction of the marks available.
- Content which was often longwinded and bore little relevance to question requirements.
- Content which was structured poorly and included muddled points.
- Content which addressed issues in the syllabus area to which the question related, but which wasn't pertinent to the issues raised in the question. For example, in response to a question requirement to identify procedures the audit team should carry out at a year-end inventory count, a significant proportion of candidates gave audit procedures that should be carried before and after the count. Such answers obtained a zero mark.

Long-form questions

The standard of answers submitted to each of the 15-mark questions varied. There was a significant number of good and very good answers to a question about the audit of inventory, but also a disappointingly high number of poor answers. Similarly, while some candidates performed well on the other 15-mark question on internal controls over a wages system, a relatively large number demonstrated weak fragmented knowledge and understanding in this regard. Of note, is that many a lack of knowledge and understanding of the term internal control objectives. Internal control objectives are a regular feature of the FAU exam and candidates should be prepared for this type of requirement.

A 10-mark question about audit working papers was answered to a satisfactory standard by most candidates. However, the other 10-mark question had a disappointingly low pass rate. This particular question tested candidates' knowledge about internal audit. It was straightforward and it is disappointing that so many struggled to achieve a pass. To aid understanding as to what a good answer needs to contain; the question, suggested solution, commentary and guidance notes are set out below.

Question

The directors of Shrub Co, a furniture manufacturing company, are considering establishing an internal audit function. However, before proceeding, they need clarification about the activities an internal audit function would typically carry out. They also want to know the extent to which a company's external auditors can use the work of the internal audit function to reduce the work they carry out.

Requirements:

- (a) **Identify THREE different types of activity an internal audit function may carry out at Shrub Co.**

(6 marks)

- (b) **Identify TWO matters external auditors should evaluate when considering whether they can use the work of the internal audit function to reduce the extent of audit procedures performed.**

(4 marks)

(Total: 10 marks)

Suggested solution:

- (a) The types of activity an internal function may carry out at Shrub Co include:
- (i) Evaluating the accounting and system of internal control of the company and reporting to management about this.
 - (ii) Reviewing the company's compliance with laws and regulations and making recommendations for improvements.
 - (iii) Advising the directors with regard to Shrub's risk management processes, including the identification of business risks and the employment of policies and procedures to avoid, transfer or mitigate the risks.
 - (iv) Carrying out value for money audits/reviewing the economy, efficiency and effectiveness of operations.
 - (v) Performing inspection of assets to confirm existence e.g. surprise cash counts.
 - (vi) Carrying out special projects or ad-hoc tasks to improve the effectiveness of Shrub Co's operations. For example, by carrying out an investigation into suspected misappropriation of inventory or by providing assistance for the company's inventory count(s).

Note: Only three types of activity are required

- (b) Per ISA 610 (Revised) *Using the Work of Internal Auditors*, Shrub Co's external auditors should evaluate the following matters about the internal audit function:
- The extent to which the function's organisational status and relevant policies and procedures support its objectivity.
 - Its level of competence.
 - Whether it applies a systematic and disciplined approach including quality control.

If the function appears to be operating effectively, the work performed by internal audit should be evaluated as to:

- Whether the work was properly planned and performed, supervised and reviewed, and documented.
- Whether sufficient and appropriate evidence has been obtained.
- Whether the conclusions reached are appropriate in the circumstances.
- Whether the reports prepared are consistent with the work performed.

Note: Only two matters are required

Commentary and guidance notes:

It was apparent that the minority of candidates who performed well on this question were familiar with the relevant content contained in ISA 610 (Revised) as summarised in the FAU Study Hub Text.

Dealing with each part of the question:

- (a) ISA 610 defines an internal audit function as ‘a function of an entity that performs activities designed to evaluate and improve the effectiveness of the entity’s risk management and internal control processes’.

Future candidates for this exam should note that each of the activities listed in the suggested solution are covered by this definition; of concern is that only a minority of candidates were able to identify two or more of these.

- (b) A significant number of candidates obtained two or fewer of the four marks available because they failed to identify any relevant matters, or because they submitted only partially correct or incomplete answers. Comprehensive coverage of these matters, as contained in ISA 610 (Revised), is included in the Study Hub Text and it is recommended that future candidates refer to this material to improve their learning in this area.

The short-form questions

It was pleasing that a good majority of candidates answered a question about audit planning to a pass standard. However, the individual pass rates for each of the other three questions (covering the auditor’s opinion, the audit procedure of inquiry and the financial statement assertion of occurrence) were disappointing, and it is evident that the large majority of candidates did not prepare adequately for questions on these topics.

Given that a high number of candidates struggled with a question about the auditor’s opinion in Section A and with an auditor’s opinion question in Section B, the short-form question together with the suggested solution, commentary and guidance notes are set out below. Careful consideration of these should help future candidates to answer any type of question on this topic.

Question

Heather Co’s financial statements for the year ended 31 July 20X5 show profit before tax of \$105,000 and total assets of \$1.6 million. The company’s auditor has concluded that profit before tax should be \$90,000 because Heather Co’s closing inventory was overstated by \$15,000.

Requirement:

Identify and explain the opinion which the auditor should express in their auditor's report on Heather Co's financial statements for the year ended 31 July 20X5.

(5 marks)

Suggested solution:

The overstatement of \$15,000 is material, because it represents 14.3% of PBT, above the benchmark materiality threshold of 5 - 10 %.

However, the overstated amount represents less than 1% of the company's total assets, and it only impacts inventory, therefore, it is not pervasive to the financial statements.

The auditor should express a qualified opinion due to material misstatement. The opinion will state 'except for' the misstatement to inventory, the financial statements give a true and fair view.

Commentary and guidance notes:

This topic features frequently in this exam, so candidates should ensure they are very familiar with each type of audit opinion and the circumstances in which each of these is appropriate as per ISA 705 (Revised) *Modifications to the Opinion in the Independent Auditor's Report*. The suggested solution is in accordance with the ISA and the detailed content of the FAU Study Hub.

As indicated in the commentary for Section A of this exam (above), the MCQ about an audit opinion was answered incorrectly by the majority of candidates. The nature of this topic lends itself to a variety of MCQs for inclusion in Section A.

Furthermore, as in this exam, the requirements of Section B questions on auditor's reports will often award marks for *identifying* the appropriate opinion to be expressed and for *explaining* the reason for this in a given scenario. It is therefore crucial that candidates possess a good understanding of this part of the FAU syllabus.

Consistent with previous sessions and as also highlighted in the Examiner's Reports pertaining to them, a significant proportion of candidates scored a low mark on this question. For many, it was simply because they ignored the requirement to explain their reasoning for stating why a specified audit opinion should be expressed.

While overall performance on the question was poor, a small minority of candidates secured at least four of the available marks with correct coverage of most or all of the points mentioned in the suggested solution. Candidates should note that the suggested solution makes reference to the numerical data contained in the question scenario to support the explanation of the type of opinion that should be expressed.

In summary, most of the answers submitted to this question were not of a pass standard due to one or more of the following reasons:

- Failure to identify that a qualified (except for...) opinion should be expressed.
- Failure to state that the misstatement is material but not pervasive.
- Failure to explain why the misstatement is material but not pervasive, by reference to the information provided in the scenario.

The majority of answers submitted to a short-form question about the financial statement assertion of occurrence were not of pass standard. For this reason, the

question requirement together with the suggested solution commentary and guidance notes are set out below.

Requirement:

(a) Explain the meaning of the financial statement assertion of occurrence.

(2 marks)

(b) Identify TWO matters an auditor should confirm when inspecting a supplier invoice and goods received note, supporting a recorded purchase transaction, to obtain assurance as to the occurrence assertion.

(3 marks)

(Total: 5 marks)

Suggested solution:

(a) Occurrence refers to the directors' assertion that the transactions and events that have been recorded or disclosed have occurred and such transactions and events pertain to the entity. (ISA 315 (Revised 2019) *Identifying and Assessing the Risks of Material Misstatements*).

(b) The auditor should confirm the following matters:

- The goods received note and supplier's invoices are authentic.
- The goods received are those normally purchased and used by the company.
- There is evidence on the goods received note (e.g. an employee signature) of the receipt of the goods by the company.
- The supplier's invoice is addressed to the company.
- The sequencing and dates of the goods received note and supplier invoice, respectively, are not unusual in any way.
- There is evidence (for example, a supervisor's signature) of checking of correct matching of the goods received note and purchase invoice, prior to recording in the company's accounting records.

Commentary and guidance notes:

The topic of financial statement assertions is a core area of the FAU syllabus, so it is of concern that a high number of candidates were unable to secure the full two marks for explaining the meaning of the occurrence assertion and were noticeably poor in demonstrating applied understanding of the topic to a straightforward requirement. As indicated in the syllabus, candidates need to ensure they know the meaning of each financial statement assertion and are able to provide several substantive procedures to obtain audit assurance about them.

Referring to each part of the question:

(a) Most candidates obtained the easy mark available for stating occurrence means the transactions and events that have been recorded or disclosed have occurred. However, only a minority obtained the additional mark for stating that such transactions and events pertain to the entity.

(b) It was apparent that only a small minority of candidates possessed a sound understanding of how an auditor obtains assurance about the occurrence of a recorded purchase transaction by inspecting a supplier invoice and the linked

goods received note. Some appeared to have a limited and confused understanding of the purpose and typical content of a goods received note and the content of a supplier (purchase) invoice. The question required candidates to make specific reference to both documents when answering. Therefore, it was puzzling as to why a high number of candidates didn't do so, submitting instead a variety of irrelevant points including those of tracing postings to the purchase and general ledgers. These submissions did not score any of the four marks available.

Conclusion

Auditing is a highly technical subject and it is generally accepted that audit 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. To achieve success, candidates need to ensure they have sound knowledge of the broad range of topics in the syllabus, and a basic appreciation of the application of auditing techniques and procedures.

The way to improve exam performance in Section A is to learn the material thoroughly, and practice answering MCQs across the full range of topics.

For Section B, candidates must ensure they have good exam technique as well as the relevant knowledge. This is best developed by attempting to write full answers to a broad range of short-form and long-form questions from all areas of the syllabus in self-imposed, time constrained exam conditions.