



# Foundations in Audit (FAU) September 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. Section A consisted of 15 multiple choice questions (MCQs) carrying a total of 30 marks. All of these questions carried 2 marks each. Section B consisted of eight questions; with two questions carrying 15 marks, two carrying 10 marks and four carrying 5 marks each. These knowledge and scenario based questions tested candidates' ability to identify and apply relevant knowledge and auditing techniques. This report should be used in conjunction with the published exam which can be found [here](#).

MCQs allow the testing of candidates' knowledge of a broad range of topics in the syllabus, and the questions in Section A achieved this objective. It was encouraging that there was a strong performance on a significant number of the MCQs but several were answered to an unsatisfactory standard. Generally, candidates fared better in the Section A questions than in Section B, with all fifteen questions in the section being attempted by all candidates. However, the questions were considered to be a fair challenge for reasonably well prepared candidates, so although there were strong performances on some of them, the overall standard of submissions to Section A was unsatisfactory.

For Section B there were some sound answers submitted to most of the questions. However, these were in the minority and as for Section A, it does seem, given the very significant number of less than satisfactory submissions, a sizeable proportion of the candidates for the exam were inadequately prepared. Common weaknesses in answers, displayed in Section B were:

- Answers which bore little relevance to the question.
- Answers which were inadequately structured and contained muddled points.
- Answers which were simply far 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 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, 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

As indicated above, the standard of responses was mixed. Failure to answer questions correctly appears to have been due to a lack of knowledge in most instances. With the exception of a question about the auditor's report, 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 exam.

A commonly held perception amongst some candidates 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 type 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 same to answer questions correctly. Many candidates did not appear to adopt the above approach (or similar) prior to attempting the exam resulting in unsatisfactory performances. The remedy to this is to adopt it when preparing for this exam next time.

### Question 15

The least well answered question in this section tested candidates' knowledge about the auditor's report. It was phrased as follows:

**Which of the following actions should an auditor take during the final stages of an audit, when audit procedures performed reveal that a company's financial statements contain material and pervasive misstatement?**

1. Irrespective of the evidence already obtained, carry out further procedures to obtain additional evidence to support an opinion that there is material and pervasive misstatement in the financial statements
2. Inform management that unless the material and pervasive misstatement is corrected, the auditor will be unable to express an unmodified audit opinion
3. Prepare to issue an auditor's report expressing a qualified audit opinion, if management refuse to correct the material and pervasive misstatement

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

An auditor's task is to audit a company's financial statements as prepared by the company's directors (management). The key word at (1) is 'irrespective'. Clearly, if an auditor is satisfied there is sufficient appropriate evidence to support an opinion, there is no requirement to obtain additional evidence. At (3), a qualified opinion

should be expressed only if the financial statements contain misstatement which is material but not pervasive. By process of elimination, the correct answer is therefore option C. The situation as presented at (2) is realistic, reflecting circumstances which may well occur in a real-life audit engagement.

### Question 8

Another question not well answered was on the area of the audit of bank and cash balances – presented as follows:

**Which of the following about the audit of reported bank and cash balances is NOT correct?**

- A. A bank letter (report) should be obtained for ALL reported bank balances at the period end
- B. B. The request for a bank letter (report), should be sent to the company's bank, directly by the auditor
- C. C. Performance materiality levels for bank and cash should be set at a lower level than that set for the financial statements as a whole
- D. D. Petty cash balances, irrespective of size, should always be counted

Note the requirement of this question is to identify the option which is NOT correct. Consequently, the best approach to adopt for answering the question is to read carefully each option in order, and ask 'is it correct?' To answer the question, candidates needed to understand the purpose and content of a bank letter (report), and the concept of materiality. By process of elimination it should become apparent that the correct answer to the question is Option D. Materiality plays a big part in the external audit process – so it's a 'must learn' topic for the FAU exam - and as petty cash balances comprise (by definition) small, immaterial in a company's financial statements; there is no requirement as such that they should be counted by the auditor.

### Question 7

A third question not well answered, was presented as follows:

**Which of the following audit procedures is a substantive procedure?**

- A. Reperforming a wages control account reconciliation already carried out by the client
- B. Comparing the trade payables payment period with that for the previous year
- C. Examining a sample of purchase orders for evidence of authorisation
- D. Tracing the steps of sales transactions through the system into the accounting records

To have confidence in answering the question correctly (Option B), candidates needed to be familiar with the term 'substantive procedures'. These are audit procedures designed to obtain evidence about assertions made by management

about what the financial statements say about client's assets, liabilities and transactions of the client and the events that affect the client's financial statements. Candidates also needed to be aware that the comparison carried out at (B) is a form of substantive procedure. A significant number of candidates taking the exam did not possess satisfactory level knowledge of substantive procedures, and were unaware that the procedures at (A) and (C) are tests of control and that (D) is a walk-through test.

## **Section B**

This section contained a broad range of knowledge and application based questions. A significant number of candidates did not possess sufficient levels of basic knowledge in core areas of the syllabus, to achieve satisfactory results. Dealing with each question in turn:

### **Questions 16-18**

The question tested candidates' knowledge of internal control, and the ability to apply the same in the context of controls exercised over inventory.

Foundations in Audit (FAU) Sample Questions - June 2020 16 of 30

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This scenario relates to three requirements.

Field Co is a large manufacturing company, with three factories, all with high overhead costs. The company carries a complex range and large quantity of inventory, comprising raw materials, work-in-progress and finished goods, and uses a continuous (perpetual) system to count it. Occasionally, the company holds significant quantities of suppliers' raw material inventory, paid for when used.

It is now 1 July 20X5 and your firm has completed the planning of its audit of the company's financial statements for the year ending 31 July 20X5.

The audit engagement partner evaluated inherent risk as high in several areas of the financial statements, including inventory. He concluded that overall control risk is low, having ascertained that the company's internal control is strong and that it has a particularly strong control environment, especially in respect of the participation of those charged with governance and its management's philosophy and operating style.

When briefing the audit team of the audit approach to be adopted, he mentioned the strong control environment but reminded team members of the inherent limitations of internal controls.

(a) Identify and explain TWO reasons why inventory is an area of high inherent risk in Field Co's financial statements. (6 marks)

Paragraph

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At (a) a significant number of candidates wasted time in explaining inherent risk rather than simply explaining two reasons as to why inventory would be an area of high inherent risk in the subject company. Similarly, many confused control risk with inherent risk. Some candidates answered this part to a satisfactory standard, but so many had only a very limited knowledge of inherent risk and the part it plays in the audit risk model.

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This scenario relates to three requirements.

Field Co is a large manufacturing company, with three factories, all with high overhead costs. The company carries a complex range and large quantity of inventory, comprising raw materials, work-in-progress and finished goods, and uses a continuous (perpetual) system to count it. Occasionally, the company holds significant quantities of suppliers' raw material inventory, paid for when used.

It is now 1 July 20X5 and your firm has completed the planning of its audit of the company's financial statements for the year ending 31 July 20X5.

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When briefing the audit team of the audit approach to be adopted, he mentioned the strong control environment but reminded team members of the inherent limitations of internal controls.

(b) Describe THREE control activities that should form part of the company's continuous (perpetual) inventory counting system, if it is to be considered effective. (6 marks)

Paragraph

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Part (b) was a well-rehearsed question, asking for a description of three control activities which should exist in an effective continuous (perpetual) inventory system. A number of candidates described control activities which should exist in a standard year-end inventory count; indicating that they either did not read the question properly or (more likely) they were not familiar with the policies and procedures that should exist over a perpetual inventory system.

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This scenario relates to three requirements.

Field Co is a large manufacturing company, with three factories, all with high overhead costs. The company carries a complex range and large quantity of inventory, comprising raw materials, work-in-progress and finished goods, and uses a continuous (perpetual) system to count it. Occasionally, the company holds significant quantities of suppliers' raw material inventory, paid for when used.

It is now 1 July 20X5 and your firm has completed the planning of its audit of the company's financial statements for the year ending 31 July 20X5.

The audit engagement partner evaluated inherent risk as high in several areas of the financial statements, including inventory. He concluded that overall control risk is low, having ascertained that the company's internal control is strong and that it has a particularly strong control environment, especially in respect of the participation of those charged with governance and its management's philosophy and operating style.

When briefing the audit team of the audit approach to be adopted, he mentioned the strong control environment but reminded team members of the inherent limitations of internal controls.

(c) Identify and explain ONE element of Field Co's control environment, other than the participation of those charged with governance and the operating style and philosophy of its management. (3 marks)

(15 marks)

Paragraph




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At (c), a number of candidates demonstrated satisfactory knowledge, when commenting on aspects of a company's control environment, but it was also apparent that others had sparse (if any) knowledge of this key area.



## Questions 18-22

### Foundations in Audit (FAU) Sample Questions - June 2020

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This scenario relates to six requirements.

Meadow Co is a provider of computer network support services and has 200 clients. The draft financial statements for the year ended 31 May 20X5 show profit before tax of \$1m, revenue of \$18m, and reported trade receivables of \$2.4m (representing a trade receivables ratio of 49 days).

It is now 1 July 20X5, and you are assisting in the audit of trade receivables as reported in Meadow Co's year-end financial statements.

After carrying out appropriate risk assessment procedures, the audit engagement manager, Sal, decided to use external confirmation, by way of a trade receivables circularisation, as one of the substantive procedures to obtain assurance about customer balances.







Having explained sampling risk and non-sampling risk, Sal has selected a sample of balances for inclusion in a positive trade receivables circularisation. The procedures include follow-up procedures where the customer disagrees with the balance stated.

The question tested knowledge of external confirmation and sampling, and the application of the same in the context of trade receivable circularisations. There was a significant number of sound answers to most parts of this question, although there was a relatively high level of confusion over the difference between a positive and negative confirmation request.

## Questions 23-24

Auditor independence forms part of the foundation of an effective audit function. It's therefore important for candidates to have a good understanding of the concept, and that it features regularly in the FAU exam.

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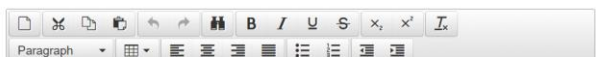
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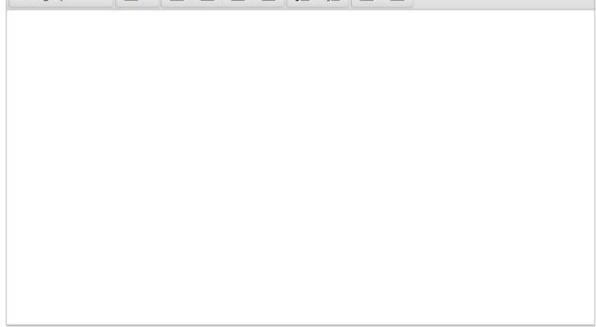
This scenario relates to two requirements.

In a recent continuing professional development workshop for audit staff, one of the speakers emphasised the importance of auditor independence and its link to integrity and objectivity. He also spoke extensively about the use of professional judgement.

As an attendee you were asked, in a case study exercise, to apply your own professional judgement to the audit of the financial statements of a company operating a hotel chain.

(a) Define auditor independence. (4 marks)



Paragraph 

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Part (a) of the question was to define audit independence, and sound answers should have included mention of physical independence, independence of mind, objectivity and integrity. While some answers were of a satisfactory standard, a significant number of candidates struggled to write cogent definitions and gained only a small fraction of the marks available.

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This scenario relates to two requirements.

In a recent continuing professional development workshop for audit staff, one of the speakers emphasised the importance of auditor independence and its link to integrity and objectivity. He also spoke extensively about the use of professional judgement.

As an attendee you were asked, in a case study exercise, to apply your own professional judgement to the audit of the financial statements of a company operating a hotel chain.

(b) Identify THREE aspects in respect of which auditors would be expected to exercise their professional judgement, when auditing the financial statements of a company operating a hotel chain. (6 marks)

(10 Marks)

Paragraph

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Part (b) comprised a requirement to identify three aspects in which auditors would be expected to exercise professional judgement when auditing the financial statements of a hotel chain. Many aspects identified were either incorrect or so generic as to be almost meaningless in the context of the requirement.

### Question 25-26

The question tested candidates' knowledge of risk assessment procedures and knowledge and application of substantive procedures.

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This scenario relates to four requirements.

Hill Co is a large company engaged in the construction of commercial buildings. Your firm has recently completed its audit of the company's most recent financial statements. You had no involvement in the risk assessment procedures carried out in the early stages of the audit. However, you did carry out a range of substantive procedures when assisting with the testing of reported bank loans, inventory and trade payables balances.

(a) State TWO TYPES of risk assessment procedure, other than inspection, which your firm was required to use, as a minimum, during its audit of Hill Co's financial statements. (2 marks)

Paragraph

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This scenario relates to four requirements.

Hill Co is a large company engaged in the construction of commercial buildings. Your firm has recently completed its audit of the company's most recent financial statements. You had no involvement in the risk assessment procedures carried out in the early stages of the audit. However, you did carry out a range of substantive procedures when assisting with the testing of reported bank loans, inventory and trade payables balances.

(b) With reference to the range of substantive procedures you carried out during the audit:

(i) Identify ONE inspection procedure that would have been appropriate in the testing of the reported bank loans balances. (2 marks)

(ii) Identify TWO substantive analytical procedures that would have been appropriate in the testing of the reported inventory balance. (4 marks)

(iii) Identify ONE recalculation procedure that would have been appropriate in the testing of the trade payables balance. (2 marks)

**(10 Marks)**

Paragraph

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Historically, FAU candidates have struggled to obtain a satisfactory marks on questions focusing on these procedures. Recommendations that candidates concentrate on improving their knowledge in these core areas of the syllabus, particularly in the regularly examined area of substantive procedures do not appear to have been adopted by the majority of candidates for this exam, and it is a situation that should be addressed for future candidates.

## Question 27

This short question tested knowledge of general IT controls and the application of the same in the context of controls to ensure continuity of operation.

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(a) Define the term 'general IT controls' in the context of a computer environment. (2 marks)

(b) Provide TWO examples of general IT controls to ensure continuity of operation. (3 marks)

**(5 marks)**

Paragraph

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The majority of candidates submitted inadequate answers to the requirements, with many incorrectly indicating that general IT controls were controls focusing only on security and safeguarding the system. For example, by way of restriction of access and use of passwords. Only a minority of candidates were able to identify two examples of general IT controls to ensure continuity of operations.

## Question 28

This question required candidates to identify two sources from which an auditor may obtain information about a prospective audit client, other than the existing auditor. It also asked for an explanation of the purpose of communicating formally with a prospective client's existing auditors.

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(a) Identify TWO sources from which an auditor may obtain information about a prospective audit client, other than the existing auditor. (3 marks)

(b) Explain the purpose of communicating, formally, with a prospective client's existing auditors. (2 marks)

**(5 Marks)**

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Candidates who gave 'existing auditors' as a source of information, had not read the question requirements properly. Similarly, a number of candidates were unaware that it is a matter of professional courtesy for an auditor who has received instructions to act for a prospective client, to communicate formally with the existing auditors.

## Question 29

There is an expectation that candidates who have achieved success in the FAU exam should have a basic level of knowledge about the contents of an unmodified auditor's report.

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With reference to an unmodified auditor's report relating to the financial statements of a limited liability company with issued share capital:

(a) State what should be clearly indicated by the title of the report. (1 mark)

Note: You should not refer to the addressee of the report in your answer.

(b) State who the report should be addressed to. (1 mark)

(c) Identify TWO matters that must be confirmed in the basis for opinion paragraph. (3 marks)

**(5 Marks)**

Paragraph

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The three parts of this question tested various aspects of this, but only a small minority of candidates answered the question to a satisfactory standard. As with substantive procedures, the auditor's report is an area of the syllabus with which

FAU candidates clearly find difficult to understand. Extra focus needs to be placed on this area in the learning process, for future FAU exams.

### Question 30

The question comprised a requirement to explain the purpose of audit software and to state two benefits of using it.

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(a) Explain the purpose of audit software. (2 marks)

(b) State TWO benefits of using audit software. (3 marks)

(5 Marks)

Paragraph

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The standard of answers varied. It was apparent that a significant number of candidates had no meaningful understanding of the term 'audit software'; while others confused the term with test data and provided an explanation of the latter.

### Conclusion

Auditing is a highly technical subject, and to pass the FAU exam candidates need to have a reasonably sound level of understanding of the full 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 reasonably sound knowledge of all the syllabus areas, particularly of the core areas.

It is important that 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 for the exam.