



Audit and Assurance (AA) March/June 2022 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

This examiner's report should be used in conjunction with the published March/June 2022 sample exam which can be found on the [ACCA Practice Platform](#).

The Audit and Assurance exam is offered in computer-based (CBE) format. The model of delivery for the CBE exam means that candidates do not always receive the same set of questions. In this 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 future candidates.

- Section A objective test (OT) case questions – here we look at the key challenge areas for this section in the exam.
- Section B constructed response questions - here we provide commentary around some of the main themes that have affected candidates' performance in this section of the exam, identifying common knowledge gaps and offering guidance on where exam technique could be improved, including in the use of the CBE functionality in answering these questions.

There are two sections to the examination and all the questions are compulsory. Section A consists of three OT cases each comprising five OT questions for a total of 30 marks, which cover a broad range of syllabus topics. In Section B candidates are presented with one constructive response question worth 30 marks and two constructive response questions worth 20 marks each; testing the candidates' understanding and application of audit and assurance in more depth.

In order to pass this examination, candidates should ensure they devote adequate time to obtain the required level of knowledge and application. Candidates who do not spend sufficient time practicing questions are unlikely to be successful as the written questions in particular aim to test candidate's application skills.

Section A

Candidates preparing for future sessions are advised to work through the past exams which are available and to carefully review how each of the correct answers were derived. Section A questions aim to provide a broad coverage of the syllabus, and future candidates should aim to revise all areas of the AA syllabus, rather than attempting to question spot.

Sample questions for discussion

The following questions are reviewed with the aim of giving future candidates an indication of the types of questions asked, guidance on dealing with exam questions and to provide a technical debrief on the topics covered by the specific questions selected. Candidates are reminded that there will be a mix of application and knowledge questions in Section A and it is imperative that they ensure their knowledge of the International Standards on Auditing (ISAs), relevant financial accounting and important areas of the syllabus such as auditors' reports is at an appropriate level. Questions may test specific details of examinable documents including ISAs, ACCA's Code of Ethics and Conduct and the UK Corporate

Governance Code, therefore candidates must ensure that they have studied these in sufficient depth. Candidates must also ensure that they have studied all areas of the syllabus. The syllabus includes audit evidence learning outcomes relating to a wide range of specific items, any of which may be examined.

Example of a case scenario

It is 1 July 20X5. You are an audit manager at Doge & Co, a medium-sized firm with several offices. As part of your role, you are responsible for undertaking procedures relating to the acceptance of new clients. You are currently involved in the acceptance of four new clients.

Bradgate Co

Bradgate Co has invited Doge & Co to perform a limited assurance review of its financial statements. Doge & Co does not provide any other services to the company.

Trimp Transport Co

The board of directors of Trimp Transport Co have set target key performance indicators (KPIs) to assess the company's performance for the year ended 31 March 20X5. The board has asked Doge & Co to perform an assessment of performance to 31 March 20X5 and to prepare a report for the board as to whether the KPIs have been achieved. The board will provide access to books and records relating to the KPIs. Doge & Co does not provide any other services to Trimp Transport Co.

Keegan Co

Keegan Co, an existing audit client, is considering setting up an internal audit department. The directors are unsure whether to hire staff or to outsource the function. Keegan Co has approached Doge & Co to enquire as to whether it could provide internal audit services.

Lette Co

Doge & Co has recently accepted a new client, Lette Co. The previous auditor, Catt & Co, resigned from the audit in May 20X5. Doge & Co was appointed on 4 June 20X5. Lette Co is in the early stages of legal action against Catt & Co for failing to detect a fraud.

Question 1

An assurance engagement can provide limited assurance or reasonable assurance.

Indicate, by clicking on the relevant boxes in the table below, whether each of the following statements is true of limited assurance, reasonable assurance or both.

An audit is an example of this type of assurance engagement	LIMITED	REASONABLE	BOTH
It provides a lower level of assurance	LIMITED	REASONABLE	BOTH
Judgement is required to determine the appropriate procedures required to obtain this level of assurance	LIMITED	REASONABLE	BOTH
A negative form of conclusion is provided	LIMITED	REASONABLE	BOTH

The correct answers are: Statement 1 = Reasonable, Statement 2 = Limited, Statement 3 = Both, Statement 4 = Limited.

This question examines candidates' understanding of two forms of assurance engagements: limited and reasonable assurance. A reasonable assurance provides a high but not absolute level of assurance and therefore the external audit is a key example of this. Limited assurance engagements provide a lower level of assurance than reasonable assurance engagements. Although the nature, timing and extent of the procedures carried out would be limited compared to those of a reasonable assurance engagement, both require planning of the procedures to obtain a level of assurance which is sufficient in the practitioner's professional judgement.

The conclusion formed in any report relating to a reasonable assurance engagement would usually be expressed in a positive form whereas a negative form would be typical of a limited assurance engagement.

Question 2

Which TWO of the following tests would Doge & Co carry out as part of the limited assurance review of Bradgate Co's financial statements?

- A. Enquire of management as to large and unusual items within the financial statements
- B. Perform analytical procedures to understand the relationship between items within the financial statements
- C. Perform tests of control to understand the controls that are operating within the company
- D. Perform extensive tests of details over all balances

The correct answers are: A & B

Limited assurance engagements provide a lower level of assurance and the conclusions convey whether a matter has come to the practitioner's attention to cause the practitioner to believe the subject matter information is materially misstated. Both enquiry of management and performing analytical procedures are appropriate tests to carry out as part of a limited assurance review.

Performing tests of controls to understand the controls that are operating within the company and performing extensive test of details over all balances are tests which would be carried out only as part of an audit, not a limited assurance engagement.

Question 3

The IAASB's Framework for Assurance Engagements (Framework) requires certain elements to be present in every assurance engagement.

Which of the elements required by the Framework is NOT present in respect of the proposed engagement for Trimp Transport Co?

- A. There must be a three-party relationship
- B. There must be appropriate subject matter relevant to the engagement
- C. There must be the ability to collect sufficient and appropriate evidence
- D. A conclusion must be formed and expressed in a written report

The correct answer is: A

One of the key elements of an assurance engagement is the three-party relationship with an intended user, a responsible party and a practitioner. The practitioner is the reviewer of the subject matter and who provides assurance, in this case Doge & Co.

The intended users are those who use the subject matter to make economic decisions and the responsible party is the party responsible for preparing the subject matter. However, in this instance, the directors of Trimp Transport Co are both the responsible party and the user therefore there is no three-party relationship.

Question 4

Identify, by clicking on the relevant boxes in the table below, whether each of the statements relating to the possible provision of internal audit services to Keegan Co by Doge & Co is TRUE or FALSE.

The risk of Doge & Co assuming management responsibility would be reduced by using a separate team of staff who are not involved in the external audit	TRUE	FALSE
Doge & Co should consider whether Keegan Co has appointed a responsible official to oversee internal audit activities	TRUE	FALSE
The materiality of the financial statement amounts affected by the internal audit service should be considered when evaluating the significance of any self-review threat	TRUE	FALSE

The correct answers are: Statement 1 = False, Statement 2 = True, Statement 3 = True.

Using a separate team of staff may reduce any potential self-review threat but would not reduce the risk of Doge & Co taking on management responsibility, therefore statement 1 is false. The ACCA Code of Ethics and Conduct (the Code) prohibits a firm or network firm from assuming management responsibility for an audit client (R600.7) and also states that “performing a significant part of the client’s internal audit activities increases the possibility that firm or network firm personnel providing internal audit services will assume a management responsibility.” (R605.4 A1)

In line with the Code, both statements 2 and 3 are true, stating:

“When providing an internal audit service to an audit client, the firm shall be satisfied that:

- a) The client designates an appropriate and competent resource, preferably within senior management, to:
 - i. Be responsible at all times for internal audit activities; and
 - ii. Acknowledge responsibility for designing, implementing, monitoring and maintaining internal control.” (R605.4)

and

“Factors that are relevant in evaluating the level of such a self-review threat include:

- The materiality of the related financial statement amounts
- The risk of misstatement of the assertions related to those financial statement amounts
- The degree of reliance that the audit team will place on the work of the internal audit service, including in the course of an external audit.” (R605.4 A4)

Question 5

Catt & Co's lawyers argued that the firm failed to detect the fraud in Lette Co's financial statements due to the inherent limitations in the audit and that it had, in fact, obtained sufficient and appropriate evidence to enable it to detect material misstatements due to fraud.

Which of the following would be an inherent limitation of the audit?

- A. Catt & Co was auditing the company for the first time and the business was new to them
- B. Due to tight reporting deadlines, Catt & Co had a limited amount of time to complete the audit
- C. Catt & Co had relied on the truth of information given to them by the company's staff
- D. Catt & Co had used audit sampling in performing tests of details

The correct answer is: D

In this requirement, further information is presented in addition to the main scenario. Where this type of information is provided, candidates must ensure that they read it carefully before attempting the question.

This question requires candidates to apply their knowledge, considering the limitations of external audit. The external audit provides reasonable assurance that the financial statements are free from material misstatement due to inherent limitations which result in the auditor forming an opinion on evidence that is persuasive rather than conclusive.

The auditor will not test 100% of all balances and transactions therefore audit sampling is considered an inherent limitation. The other potential options in this question represent detection risks or failure to carry out work properly which could have been avoided.

Section B

Esk Co

AA March/June 2022 (21/22 syllabus)

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This scenario relates to four requirements.

It is 1 July 20X5. You are an audit supervisor with Bannock & Co and are responsible for planning the audit of a new client, Esk Co, for the year ending 31 August 20X5. Your audit manager recently met with the finance director of Esk Co and has provided you with the following planning meeting notes and financial statement extracts:

Planning meeting notes
Esk Co is a manufacturer and wholesaler of plumbing supplies. It operates from two warehouses which are situated in the north and south of the country. Extracts from the forecast financial statements for the year ending 31 August 20X5 and the final financial statements for 20X4 are as follows:

	Forecast 20X5 \$m	Final 20X4 \$m
Revenue	30.9	27.5
Cost of sales	(22.5)	(19.9)
Gross profit	8.4	7.6
Inventories	8.3	6.4
Trade receivables	7.2	4.9
Trade payables	2.4	3.5

In September 20X4, Esk Co purchased a patent for \$2.6m which gives it the exclusive right to manufacture a waste disposal system for a four-year period. The purchase cost capitalised comprises the cost of the patent and other costs such as legal fees and administrative costs incurred in negotiating the contract. In order to finance this purchase, Esk Co obtained an interest-bearing bank loan of \$2.5m during the year. The bank loan is payable in five equal annual instalments, with the first instalment due to be paid on 1 September 20X5.

The payables ledger clerk has recently discovered a batch of supplier invoices that had been mis-coded and therefore had not been recorded as trade payables. This error has now been corrected but investigations are still ongoing to determine how this happened and whether any other batches of invoices have been mis-coded.

There was a fire in the south warehouse in June 20X5 which resulted in damaged inventory. An inventory count immediately following the fire identified that inventory costing \$1.1m required to be fully written off. The damaged inventory has not yet been replaced as there is sufficient inventory in the north warehouse to satisfy demand. The directors have raised a claim against Esk Co's insurance company to cover the full extent of the lost inventory. Although no confirmation has been received from the insurance company, the directors are confident that the full amount claimed of \$1.1m will be received and have included this amount as other receivables within current assets.

ISA 210 Agreeing the Terms of Audit Engagements requires an auditor to establish whether the preconditions for an audit are present prior to accepting an audit engagement.

(a) Describe the PRECONDITIONS for an audit that Bannock & Co should have established prior to accepting the audit of Esk Co. (4 marks)

This 30-mark question is based on Esk Co, a manufacturer and wholesaler of plumbing supplies. This question tests candidates' knowledge of preconditions for accepting an audit engagement, ratio calculations, audit risks and responses and substantive procedures for trade receivables.

Requirement (a) – 4 marks

Describe the PRECONDITIONS for an audit that Bannock & Co should have established prior to accepting the audit of Esk Co.

This is a relatively straightforward knowledge requirement which has been tested in previous exam sessions. Knowledge requirements such as this often have an opening statement, sometimes referenced to an International Standard on Auditing (ISA), and this is useful for setting the scene and providing clarification on the aim of the question requirement. It is especially important that candidates understand exactly what the question is asking, especially for knowledge questions, where candidates should be aiming to score full marks.

Question requirements such as this demonstrate the importance of having a detailed understanding of the ISAs, and in this case ISA 210 Agreeing the Terms of Audit Engagements. For a four-mark knowledge requirement such as this, candidates should aim to provide four well-described points. For example, 'management should confirm their preparation of financial statements' would be awarded $\frac{1}{2}$ marks. In order to gain the additional $\frac{1}{2}$ mark this should be expanded to include 'in accordance with the applicable framework'.

Care should be taken when reading the requirement to ensure that answer points focus on the right issues. For example, in this session some candidates incorrectly focused their answers on pre acceptance procedures such as ensuring adequate staff were available, obtaining professional clearance from the previous auditors, independence issues and preparing engagement letters, all of which were not relevant. Candidates must take the time to carefully read and underline key words in the requirement, in order to ensure their answer is relevant.

Requirement (b) – 4 marks

AA March/June 2022 (21/22 syllabus)

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This scenario relates to four requirements.

It is 1 July 20X5. You are an audit supervisor with Bannock & Co and are responsible for planning the audit of a new client, Esk Co, for the year ending 31 August 20X5. Your audit manager recently met with the finance director of Esk Co and has provided you with the following planning meeting notes and financial statement extracts:

Planning meeting notes

Esk Co is a manufacturer and wholesaler of plumbing supplies. It operates from two warehouses which are situated in the north and south of the country. Extracts from the forecast financial statements for the year ending 31 August 20X5 and the final financial statements for 20X4 are as follows:

	Forecast 20X5 \$m	Final 20X4 \$m
Revenue	30.9	27.5
Cost of sales	(22.5)	(19.9)
Gross profit	8.4	7.6
Inventories	8.3	6.4
Trade receivables	7.2	4.9
Trade payables	2.4	3.5

In September 20X4, Esk Co purchased a patent for \$2.6m which gives it the exclusive right to manufacture a waste disposal system for a four-year period. The purchase cost capitalised comprises the cost of the patent and other costs such as legal fees and administrative costs incurred in negotiating the contract. In order to finance this purchase, Esk Co obtained an interest-bearing bank loan of \$2.5m during the year. The bank loan is payable in five equal annual instalments, with the first instalment due to be paid on 1 September 20X5.

The payables ledger clerk has recently discovered a batch of supplier invoices that had been mis-coded and therefore had not been recorded as trade payables. This error has now been corrected but investigations are still ongoing to determine how this happened and whether any other batches of invoices have been mis-coded.

There was a fire in the south warehouse in June 20X5 which resulted in damaged inventory. An inventory count immediately following the fire identified that inventory costing \$1.1m required to be fully written off. The damaged inventory has not yet been replaced as there is sufficient inventory in the north warehouse to satisfy demand. The directors have raised a claim against Esk Co's insurance company to cover the full extent of the lost inventory. Although no confirmation has been received from the insurance company, the directors are confident that the full amount claimed of \$1.1m will be received and have included this amount as other receivables within current assets.

(b) Using the table below, calculate the following FOUR ratios, for BOTH years, to assist you in planning the audit of Esk Co: gross profit margin, inventory holding period, receivables collection period and payables payment period.

Note: Formulas are not required to be shown. (4 marks)

(c) Using the information provided and the ratios calculated, describe EIGHT audit risks and explain the auditor's response to each risk, in planning the audit of Esk Co. (16 marks)

Ratio	20X5	20X4
Gross profit margin		
Inventory holding period		
Receivables collection period		
Payables payment period		

(c)

Audit risk	Auditor's response

Using the table below, calculate the following FOUR ratios, for BOTH years, to assist you in planning the audit of Esk Co: gross profit margin, inventory holding period, receivables collection period and payables payment period.

Marks are awarded for the calculation of the relevant ratio for each year ($\frac{1}{2}$ mark each) and so eight ratios should be calculated in just over seven minutes. The marks are only awarded for the correct answer and the requirement clearly states that formulas are not required to be shown.

With only $\frac{1}{2}$ mark available per ratio, credit is not awarded for the calculations. Therefore if a candidate simply provides the calculation without the final answer, no credit will be gained. It is clear from reviewing candidates' answers that some fail to bring a calculator into the exam, as they only list the calculations. Candidates are reminded that a calculator could be required for ratio calculations as well as to assess materiality in audit report requirements.

In this session candidates were able to confidently calculate all of the required ratios and these all related to profitability and liquidity. However, candidates must ensure that they are able to calculate all ratios within the syllabus, and not just the main liquidity and profitability ratios.

Requirement (c) – 16 marks

Using the information provided and the ratios calculated, describe EIGHT audit risks and explain the auditor's response to each risk, in planning the audit of Esk Co.

Marks are awarded for identification of audit risks ($\frac{1}{2}$ mark each), explanation of audit risks ($\frac{1}{2}$ mark each) and an appropriate auditor's response to each risk (1 mark each). With a scenario-based requirement such as this, good exam technique is critical.

The scenario will typically contain more than the number of risks required, so it is important that candidates plan their time carefully and only attempt to list the required number of points.

The first step is to identify the factors which will give rise to an audit risk. This information can be found in the scenario. All of the information in the scenario should be read carefully, including the opening paragraph as this may include information relevant to the identification of audit risks, such as whether this is a new client, as was the case in Esk Co, and is often overlooked. When undertaking this read through it would be good exam technique to use the highlight function as this provides a visual aid for quickly spotting audit risks. Having looked at the whole scenario and highlighted relevant points, candidates should pick their eight strongest points, re-reading them from the scenario, drafting their answer as they go along.

Candidates often use the copy and paste function when drafting their answers for the identification of the risk. However, care should be taken to ensure that the risk is actually identified. For example, this session some candidates stated 'Esk Co purchased a patent for \$2.6m' this in itself is not the audit risk, as it is the fact that 'administrative costs have been included within the intangible asset'.

Financial accounting knowledge is also important as audit risks will often focus on the accounting treatment used in the financial statements. In Esk Co, accounting issues which give rise to audit risks include those relating to intangible assets, bank loans, inventory valuation, contingent assets and a provision. The risk least identified by candidates related to Esk being a new client. Candidates should expect a range of topic areas within an audit risk scenario, some of which may be more challenging than others.

When tackling audit risk questions which include ratios, the results of the calculations should be considered when identifying the risks. Where the movement in the ratio year on year is minimal, as in the case of the gross profit margin which decreased from 27.6% to 27.2%, then it is unlikely this movement will lead to a significant audit risk. However in the case of the significant movement of the receivables collection period along with the information in the scenario about the lack of an experienced credit controller, this identifies a possible risk of overvaluation of trade receivables. Some candidates incorrectly used this information to generate two audit risks, both relating to overstated receivables with similar auditor responses. Candidates should note that if two pieces of information result in the same audit risk then credit is only available once as the information should be used in conjunction.

Having identified the risk factor, the next step is to explain the risk. To do this, candidates need to state the specific area of the financial statements impacted with an assertion (for example cut off, valuation etc.) or a reference to over/under/misstated or a reference to inherent/ control/ detection risk. 'Misstated' will only be awarded if it is clear the balance could be either over or understated. For example, if the risk should have been described in terms of an understated balance, then no credit would be awarded if candidates referred to a misstated balance. Candidates cannot play it safe by providing both options. For the new bank loan, some candidates explained that the split of the loan between current and non current liabilities may not be correct. However without stating the assertion, that the loan may be misclassified, credit would not be awarded.

The explanation of the risk must also clearly state the specific area of the financial statements impacted. For example, in respect of the issue relating to the capitalisation of admin costs within the patent, only noting 'non-current assets or assets could be overstated' would not be awarded credit. An appropriate explanation in this instance would be 'intangible assets could be overstated'.

In addition, some risk explanations were inappropriate. For example, candidates explained the issue of the sales staff being paid a bonus based on the last quarter's sales as being a risk over the calculation of the bonus. Instead, this risk should have been explained as leading to a cut off risk with revenue being overstated in order for sales staff to maximise their bonus. Candidates must take the time to carefully read the scenario, noting any relevant information, to ensure that they correctly understand and describe the audit risks arising.

Having identified and explained the risk, the next step is to provide the auditor's response. Responses must be practical within the context of the scenario and care should be taken to ensure the response is one an auditor would make and not a management response. In this session candidates provided management responses for the audit risks relating to the miscoded invoices, damaged inventory and lack of an experienced credit controller. Suggesting that 'the company appoint an experienced credit controller' will not help the auditor to form a conclusion on whether trade receivables are overvalued, this is a management response rather than an auditor's response. Candidates are advised to take a moment to read their responses with this in mind.

Auditor responses do not have to be a detailed procedure, rather it is an approach the audit team will take. Care must be taken however, to ensure that the approach suggested actually addresses the risk identified and contains sufficient detail. A response of 'discuss with management' will not gain any credit as candidates need to be very clear exactly 'what' they are 'asking management' about. For the new bank loan risk, responses which simply stated 'recalculate the split of the loan in the financial statements' were only awarded ½ mark as they also needed to agree the loan to a loan agreement to gain the full 1 mark available.

Where further documentary evidence is available to the auditor, candidates need to refer to this to gain the available 1 mark per response. Also, consideration should be given to the reliability of audit evidence gained; for example, evidence gained via confirmation from a third party will be more reliable than verbal assertions from management. Candidates should also consider the practicality of obtaining the evidence, suggesting 'the audit team should write to the insurance company to ask if the claim of \$1.1m will be paid' is not valid, as the insurance company is still processing the claim so they will not provide an answer on this to the auditor. Additionally for the insurance claim many candidates suggested 'contacting Esk Co's lawyer to understand the likelihood of the insurance claim being successful'. Contacting the company's lawyers is only valid in the case where Esk Co is suing or being sued by someone.

Candidates often suggest 'increased professional scepticism' for a whole range of audit risks, and whilst valid, it is not on its own a suitable auditor's response for 1 mark. This is because increasing scepticism does not, on its own, help the auditor to gain suitable audit evidence over the identified audit risk.

Future candidates are advised that audit risk is and will continue to be an important element in the syllabus and must be understood. Candidates must ensure that they include adequate question practice as part of their revision on this key topic.

Peach Co from the 'Sample September/December 2021 Questions', Corley Appliances Co from the 'Sample March/June 2021 Questions', Hart Co from the 'Sample September/December 2020 Questions', Harlem Co from the 'Sample September/December 2019 Questions', Peony Co from the 'Sample March/June 2019 Questions' and Scarlet Co from the 'Sample March/June 2020 Questions' are all good scenario-based questions on audit risks and responses to practice.

Requirement (d) – 6 marks

AA March/June 2022 (21022 syllabus)

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This scenario relates to four requirements.

It is 1 July 20X5. You are an audit supervisor with Bannock & Co and are responsible for planning the audit of a new client, Esk Co, for the year ending 31 August 20X5. Your audit manager recently met with the finance director of Esk Co and has provided you with the following planning meeting notes and financial statement extracts:

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In September 20X4, Esk Co purchased a patent for \$2.6m which gives it the exclusive right to manufacture a waste disposal system for a four-year period. The purchase cost capitalised comprises the cost of the patent and other costs such as legal fees and administrative costs incurred in negotiating the contract. In order to finance this purchase, Esk Co obtained an interest-bearing bank loan of \$2.5m during the year. The bank loan is payable in five equal annual instalments, with the first instalment due to be paid on 1 September 20X5.

The payables ledger clerk has recently discovered a batch of supplier invoices that had been mis-coded and therefore had not been recorded as trade payables. This error has now been corrected but investigations are still ongoing to determine how this happened and whether any other batches of invoices have been mis-coded.

There was a fire in the south warehouse in June 20X5 which resulted in damaged inventory. An inventory count immediately following the fire identified that inventory costing \$1.1m required to be fully written off. The damaged inventory has not yet been replaced as there is sufficient inventory in the north warehouse to satisfy demand. The directors have raised a claim against Esk Co's insurance company to cover the full extent of the lost inventory. Although no confirmation has been received from the insurance company, the directors are confident that the full amount claimed of \$1.1m will be received and have included this amount as other receivables within current assets.

(d) Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Esk Co's trade receivables.

(5 marks)

(30 marks)

Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Esk Co's trade receivables.

For substantive procedures requirements, one mark is available for each well-described procedure, therefore candidates should aim to produce six tests for this requirement. Candidates should plan their time accordingly. Also, candidates should note that it is not necessary to write out the question requirement at the beginning of their answer, it does not gain any credit and therefore wastes time.

When describing substantive procedures, one of the key things to consider is the level of detail provided. Many candidates fail to score well in this type of requirement because their procedures are vague or too brief. Tests must be sufficiently detailed, noting clearly which source document should be used and for what purpose. For example, in this session some candidates included, 'review after date cash receipts' and would have only gained ½ mark. In order to gain the 1 mark available this test would need to be expanded to 'follow these receipts through to the pre year end receivables balance'.

Candidates must ensure that they can distinguish between a substantive procedure and a test of control. Many candidates lose marks in this type of requirement by mixing up these procedures. Where substantive procedures are required for an account balance subject to an accounting standard then considering the rules of the standard can help in generating targeted substantive procedures.

In many substantive procedure questions analytical procedures can be an important source of evidence, but for one off types of expenditure then analytical review is unlikely to be useful. For trade receivables, then, valid analytical procedures such as 'comparing the trade receivables to the prior year with significant differences being discussed with management' would gain the full one mark. Candidates who 'compare the balance to the prior year and identify any significant differences' only gained $\frac{1}{2}$ marks as the process of comparing current to prior year only identifies the differences. To gain the other $\frac{1}{2}$ marks these significant differences need to be investigated or discussed further with management.

Candidates who focused on 'casting the receivables listing and agreeing to financial statements', 'preparing a receivables circularisation', 'reviewing after date cash receipts', 'reviewing the aged receivables reports for slow moving balances and discussing with management the need for an allowance', 'reviewing customer correspondence for balances in dispute' and 'undertaking analytical review procedures' were able to gain credit.

When generating substantive procedures for trade receivables or trade payables, it is imperative that the focus of the tests is on the statement of financial position balance rather than on revenue or purchases. In this session some candidates incorrectly provided revenue procedures such as 'recalculate the total on the sales invoices' and 'agree goods dispatched notes to the sales invoice and sales day book,' and these did not gain credit. Take the time to read the question requirements carefully and spend time thinking about what is needed prior to producing an answer.

Whittaker Co

This 20-mark question is based on Whittaker Co, a manufacturer of luxury bed linen which sells wholesale to the hotel trade and direct to the public. This question tests candidates' knowledge of communicating deficiencies in internal control to those charged with governance, direct controls and test of controls and deficiencies and control recommendations.

Requirement (a) – 4 marks

AA March/June 2022 (21/02 syllabus)

Symbol Highlighter Steinhilber Calculator Scratch Pad

This scenario relates to four requirements.

It is 1 July 20X5. You are an audit supervisor with Walsh & Co. You are currently reviewing notes in relation to the internal controls in place at your client, Whittaker Co. Whittaker Co manufactures and sells luxury bed linen wholesale to the hotel trade and direct to the public from its factory store. It has a year ending 31 August 20X5.

Sales

Whittaker Co implemented a new sales system in May 20X5. The new system was fully tested prior to its implementation and will be run in parallel with the old system until the year end. Whittaker Co's internal audit (IA) department is responsible for comparing the output from the old and new systems, investigating any discrepancies and making recommendations for further action.

The company operates a fully automated credit check process for all its new hotel customers. The automated system generates a credit limit for each new customer which the sales director approves before the customer can place any orders. She evidences her approval in the system.

On a monthly basis, the receivables ledger clerk downloads the aged receivables report and reviews it for outstanding debts. In line with Whittaker Co's credit control policy, any debts which are greater than 30 days overdue are then passed to the credit control department which contacts the customers to resolve any issues and recover the debt. Also on a monthly basis, the accounts clerk reconciles the receivables ledger control account to the receivables ledger in order to verify the month and receivables balance. Any reconciling items are documented, errors are corrected on a timely basis and then the reconciliations are reviewed and approved by the financial controller.

Payroll

Whittaker Co has a human resources (HR) department which is responsible for processing joiners and leavers, including preparing and sending authorised joiners forms to the payroll department so that new employees can be set up correctly on the payroll system. However, when additional staff are required at short notice, joiners forms are not completed and instead, the production supervisor notifies the payroll department by email on the day they commence employment.

Staff are required to work overtime on a regular basis in order to meet production targets. Overtime is paid monthly in arrears, at the end of the month in which it is worked. All overtime reports are reviewed on a quarterly basis by the production supervisor after the overtime has been paid. Reviews of overtime reports are evidenced by signature of the production director.

The payroll system automatically calculates wages and deductions for all employees based on standing data. The standing data is reviewed regularly to ensure it is still accurate however no checks are performed on the monthly payroll calculations.

In May each year, all employees receive a bonus, the amount of which varies depending upon their performance. The payroll department receives written notification from the HR manager of the bonus, based only on his view of the employees' performance in the year. The bonuses for 20X5 were input into the payroll system by the payroll clerk. After May's payroll had been processed, a small number of employees notified the payroll department that the bonus they had been paid did not agree to their bonus confirmation letter. This was corrected in June 20X5.

Bank

Whittaker Co uses an internet banking system which requires a two-step verification process. A password is required to log on to the system. An

Auditors are required, under ISA 265 Communicating Deficiencies in Internal Control to Those Charged with Governance and Management, to communicate in writing to those charged with governance any significant deficiencies in internal control.

(a) Describe FOUR matters the auditor may consider in determining whether a deficiency in internal control is significant.

Note: You do not need to refer to the scenario to answer this requirement.

(4 marks)

Describe FOUR matters the auditor may consider in determining whether a deficiency in internal control is significant.

This is a knowledge requirement which has been tested in previous exam sessions. For knowledge requirements such as this, it is important that candidates understand exactly what the question is asking, especially where candidates should be aiming to score full marks. For this session candidates were required to describe matters in determining whether a deficiency is significant for 4 marks. As the requirement verb was 'describe' candidates need to ensure that they include sufficient detail in their answers. Simply providing a few words such as 'materiality of deficiency' is not enough for a description. Candidates therefore need to consider whether they have written enough.

Commonly awarded points included 'complexity of deficiencies' and 'frequency of deficiencies.' However, these points would only gain ½ marks as they are too brief. To gain the additional ½ marks, candidates need to consider 'the complexity when determining estimates' and 'the frequency of exceptions identified as a result of the deficiencies'.

It is also important that candidates pay attention to any elements of the requirement which are highlighted. In this session the word FOUR was in capitals. This was specifically done to focus candidates' answers, so that they would know to provide four well described answers. Additionally, there was a note under the requirement which stressed that the scenario did not need to be referred to in answering this requirement. Unfortunately, during this session some candidates ignored this note and provided control deficiencies from the scenario which were required for part (c).

Notes and capitalisation of words in requirements are there to guide candidates and to help, candidates should be careful not to ignore them.

It is imperative that future candidates ensure that they devote adequate time to learning the knowledge areas of the syllabus as well as practicing this style of knowledge question. Good example questions to practice are Pomeranian Co from the 'Sample September/December 2021 Questions', Castle Couriers Co from the 'Sample March/June 2021 Questions', Swift Co from the 'Sample September/December 2020 Questions', Snowdon Co from the 'Sample March/June 2020 Questions', Amberjack Co from the 'Sample September/December 2019 Questions' and Freesia Co from the 'Sample March/June 2019 Questions'.

Requirement (b) – 6 marks

AA March/June 2022 (21/22 syllabus)

Symbol Highlight Spellcheck Calculator Scratch Pad

This scenario relates to four requirements.

It is 1 July 20X5. You are an audit supervisor with Walsh & Co. You are currently reviewing notes in relation to the internal controls in place at your client, Whittaker Co. Whittaker Co manufactures and sells luxury bed linen wholesale to the hotel trade and direct to the public from its factory store. It has a year ending 31 August 20X5.

Sales
Whittaker Co implemented a new sales system in May 20X5. The new system was fully tested prior to its implementation and will be run in parallel with the old system until the year end. Whittaker Co's internal audit (IA) department is responsible for comparing the output from the old and new systems, investigating any discrepancies and making recommendations for further action.

The company operates a fully automated credit check process for all its new hotel customers. The automated system generates a credit limit for each new customer which the sales director approves before the customer can place any orders. She evidences her approval in the system.

On a monthly basis, the receivables ledger clerk downloads the aged receivables report and reviews it for outstanding debts. In line with Whittaker Co's credit control policy, any debts which are greater than 30 days overdue are then passed to the credit control department which contacts the customers to resolve any issues and recover the debt. Also on a monthly basis, the accounts clerk reconciles the receivables ledger control account to the receivables ledger in order to verify the month end receivables balance. Any reconciling items are documented, errors are corrected on a timely basis and then the reconciliations are reviewed and approved by the financial controller.

Payroll
Whittaker Co has a human resources (HR) department which is responsible for processing joiners and leavers, including preparing and sending authorised joiners forms to the payroll department so that new employees can be set up correctly on the payroll system. However, when additional staff are required at short notice, joiners forms are not completed and instead, the production supervisor notifies the payroll department by email on the day they commence employment.

Staff are required to work overtime on a regular basis in order to meet production targets. Overtime is paid monthly in arrears, at the end of the month in which it is worked. All overtime reports are reviewed on a quarterly basis by the production supervisor after the overtime has been paid. Reviews of overtime reports are evidenced by signature of the production director.

The payroll system automatically calculates wages and deductions for all employees based on standing data. The standing data is reviewed regularly to ensure it is still accurate however no checks are performed on the monthly payroll calculations.

In May each year, all employees receive a bonus, the amount of which varies depending upon their performance. The payroll department receives written notification from the HR manager of the bonus, based only on his view of the employees' performance in the year. The bonuses for 20X5 were input into the payroll system by the payroll clerk. After May's payroll had been processed, a small number of employees notified the payroll department that the bonus they had been paid did not agree to their bonus confirmation letter. This was corrected in June 20X5.

Bank
Whittaker Co uses an internet banking system which requires a two-step verification process. A password is required to log on to the system. An

(b) In respect of the SALES system of Whittaker Co:

(i) Identify and explain THREE DIRECT CONTROLS on which the auditor may seek to place reliance; and

(ii) Describe a TEST OF CONTROL the auditor should perform to assess if each of these direct controls is operating effectively.

Note: The marks will be split equally between each part. (6 marks)

Direct control	Test of control

In respect of the SALES system of Whittaker Co:

- (i) **Identify and explain THREE DIRECT CONTROLS on which the auditor may seek to place reliance; and**
- (ii) **Describe a TEST OF CONTROL the auditor should perform to assess if each of these direct controls is operating effectively.**

Marks are awarded for identification of direct controls (½ mark each), explanation of the implication of the direct control to the company (½ mark each) and an appropriate test of control for each control (1 mark each).

In common with risks questions, the scenario will typically contain more than the number of direct controls required, so it is important that candidates plan their time carefully and only attempt to list the required number of points. With this type of requirement good exam technique is absolutely critical.

As stated in previous Examiner's reports, candidates should be prepared to answer questions which cover direct controls and tests of controls, control deficiencies and recommendations or a combination of both. Whittaker Co examines both direct controls and deficiencies and focuses on different parts of the internal control system. Questions may also be set where direct controls and deficiencies are tested but in relation to a single part of a company's system.

In order to be a direct control, candidates need to consider whether the control as described has been appropriately designed and is being operated in such a way that it would in fact prevent or detect a material misstatement. Therefore, when identifying direct controls, it is important that the control described is complete. For example, the fact that the monthly control accounts are reconciled is not in itself a direct control. Additional checks would need to be undertaken to ensure that the process has been undertaken fully. To be effective as a direct control the reconciliations would need to be reviewed by a responsible official who would ensure that any errors have been resolved.

Some candidates are under the misconception that each sentence in the scenario contains a direct control. This is not the case. The scenario will include information which describes the way in which the system operates but not all of this information will indicate a direct control. Candidates who then break down each line into a different point end up wasting time and not gaining credit. In this session some candidates split a direct control into two points. As only three controls were required, this resulted in very few marks being gained. For example, the automatic credit check and review of credit limits by the sales director are not separate controls as any system generated credit limit would need to be reviewed for reasonableness by a responsible official.

Having identified direct controls, candidates then need to explain each control. In considering this it is important to think about what the aim of the control is, what potential misstatement is being prevented or detected. The explanation needs to be specific to each control. It is not sufficient to state 'this will prevent fraud and error' as all controls aim to prevent or detect fraud and error in some way. A clear understanding of specifically how the control will prevent fraud and error is needed. For example, in this session the scenario contained a control whereby a new sales system was implemented and internal audit fully tested the system by comparing output from the old and new systems. An appropriate explanation would be that the aim of this control is to ensure that this reduces the risk of loss of/ incomplete data when transferring to the new system.

The last part of the requirement is for candidates to describe tests of controls for each direct control identified. To gain the 1 mark available it is imperative that the descriptions of the tests are detailed enough. A test which starts with 'check' is unlikely to provide sufficient detail as to how exactly the auditor will test the control, detail must be given on specifically what is being done to achieve a check, the word itself is not enough. In addition, it must be remembered that tests of controls are procedures carried out by the auditor, therefore candidates need to ensure that they focus on what the auditor should do rather than provide recommendations for management.

In considering how to test the control, a useful starting point is to consider if there are any documents which can be inspected as this is likely to provide strong evidence that the control is operating. However, when describing the test it is important to clearly state what document is being inspected and also for what purpose. In this session, the scenario contained a direct control where the aged receivables report was reviewed and passed to credit control for the chasing of overdue debts. In testing this control an appropriate response would be that the 'aged receivables reports are inspected' and in this case that it is 'for evidence of review by credit control'.

In addition, in describing tests of controls, it is important that key elements of the control are tested. This session the scenario contained a direct control over automatic credit checks and review of limits by the sales director. Some candidates recommended that in order to test this ‘a dummy customer should be entered into the system to see if a credit limit is generated’. This is not a valid test in this situation as the system would not be able to generate a credit limit as there would not be any real world data on which to assess the creditworthiness of the customer.

In addition, tests such as ‘observe’ do not score as well as inspection or some enquiry type procedures. Where more reliable evidence sources are available, these should be used to test the controls. In this session, ‘observation’ was not credited for any of the direct controls as in each case more reliable evidence could be generated through enquiry or inspection. In addition, candidates should ensure that they do not confuse tests of control with substantive procedures. For the control over the review of aged receivables reports, some candidates suggested ‘review after date cash receipts’ however, this is a substantive procedure rather than a test of control and so would not have gained any credit.

Direct controls and tests of controls are a key requirement in internal control questions and future candidates must ensure they practice these types of questions in advance of their exam. Castle Courier Co from the ‘Sample March/June 2021 Questions’, Swift Co from the ‘Sample September/December 2020 Questions’ and Snowdon Co from the ‘Sample March/June 2020 Questions’ are good questions to practice.

Requirement (c) – 10 marks

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Symbol Highlight Steeltough Calculator Scratch Pad

This scenario relates to four requirements.

It is 1 July 20X5. You are an audit supervisor with Walsh & Co. You are currently reviewing notes in relation to the internal controls in place at your client, Whittaker Co. Whittaker Co manufactures and sells luxury bed linen wholesale to the hotel trade and direct to the public from its factory store. It has a year ending 31 August 20X5.

Sales
Whittaker Co implemented a new sales system in May 20X5. The new system was fully tested prior to its implementation and will be run in parallel with the old system until the year end. Whittaker Co's internal audit (IA) department is responsible for comparing the output from the old and new systems, investigating any discrepancies and making recommendations for further action.

The company operates a fully automated credit check process for all its new hotel customers. The automated system generates a credit limit for each new customer which the sales director approves before the customer can place any orders. She evidences her approval in the system.

On a monthly basis, the receivables ledger clerk downloads the aged receivables report and reviews it for outstanding debts. In line with Whittaker Co's credit control policy, any debts which are greater than 30 days overdue are then passed to the credit control department which contacts the customers to resolve any issues and recover the debt. Also on a monthly basis, the accounts clerk reconciles the receivables ledger control account to the receivables ledger in order to verify the month and receivables balance. Any reconciling items are documented, errors are corrected on a timely basis and then the reconciliations are reviewed and approved by the financial controller.

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Whittaker Co has a human resources (HR) department which is responsible for processing joiners and leavers, including preparing and sending authorised joiners forms to the payroll department so that new employees can be set up correctly on the payroll system. However, when additional staff are required at short notice, joiners forms are not completed and instead, the production supervisor notifies the payroll department by email on the day they commence employment.

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The payroll system automatically calculates wages and deductions for all employees based on standing data. The standing data is reviewed regularly to ensure it is still accurate however no checks are performed on the monthly payroll calculations.

In May each year, all employees receive a bonus, the amount of which varies depending upon their performance. The payroll department receives written notification from the HR manager of the bonus, based only on his view of the employees' performance in the year. The bonuses for 20X5 were input into the payroll system by the payroll clerk. After May's payroll had been processed, a small number of employees notified the payroll department that the bonus they had been paid did not agree to their bonus confirmation letter. This was corrected in June 20X5.

Bank
Whittaker Co uses an internet banking system which requires a two-step verification process. A password is required to log on to the system. An

(c) Identify and explain FIVE DEFICIENCIES in Whittaker Co's PAYROLL and BANK systems and provide a control recommendation to address each of these deficiencies. (10 marks)

(20 marks)

Control deficiency	Control recommendation

Help Previous Navigator Next

Identify and explain FIVE DEFICIENCIES in Whittaker Co's PAYROLL and BANK systems and provide a control recommendation to address each of these deficiencies.

Marks are awarded for identification of deficiencies (½ mark each), explanation of the implication of the deficiency to the company (½ mark each) and an appropriate control recommendation to address each deficiency (1 mark each).

The scenario will typically contain more than the number of deficiencies required and it remains important that candidates plan their time carefully and only attempt to list

the required number of points. Continuing to apply good exam technique and time management skills is critical.

The first step in tackling a deficiencies question is to read through the whole scenario in full, this gives an understanding of what the potential answer points are as some deficiencies are easier to explain than others. Having looked at the whole scenario then candidates should re-read it, drafting their answer as they go along. Do not be daunted by the length of the scenario, be methodical and keep re-reading the requirement to stay focused. In a multi cycle question such as Whittaker Co there is likely to be a good cross section of points across each of the two cycles presented.

In identifying deficiencies, it is important to record what the actual deficiency from the scenario is. Candidates can pick the fact from the scenario but fail to spot what the actual deficiency is. For example, candidates identified from the scenario 'the overtime reports are reviewed on a quarterly basis'. However, the actual issue was that the reports are being reviewed after the overtime has been paid. This was required for the ½ mark available for identification of the deficiency as simply stating part of what was in the scenario did not sufficiently detail the deficiency.

Candidates must also be careful not to identify irrelevant deficiencies. For example, in the scenario it stated that the accounts clerk undertakes bank reconciliations on a weekly basis. This is not a deficiency, as it's sufficiently regular for bank reconciliations to be undertaken weekly. Therefore, any answers which criticised this method and recommended daily bank reconciliations did not gain credit. Other incorrect answers focused on the production supervisor being too junior to review the overtime and the financial controller not reviewing the bank reconciliations as this should be undertaken by the finance director. Candidates often incorrectly identify deficiencies relating to accounts/finance clerks being too junior to undertake any elements of internal controls systems. This demonstrates a lack of understanding of internal control systems and candidates should take time to develop their knowledge by practising past exam questions.

Having identified deficiencies, candidates are required to explain the implication to the business to be awarded credit. For example, a valid explanation for the deficiency 'staff added to the payroll without joining forms being completed' (identification ½ mark awarded), would have been 'this could result in fictitious employees being added to the payroll'. Answers which just stated 'the production supervisor may recruit staff without relevant experience' would not have gained credit as it is unlikely that the supervisor would not know what skills are required to undertake the role. The key implication to the company is that if appropriate checks are not completed then the payroll system could be fraudulently circumvented.

The explanation needs to be specific to each deficiency, as it is not sufficient to state 'this will result in fraud/error' as all deficiencies can lead to increased fraud and error. A clear understanding of how the deficiency will result in 'fraud and error' is needed. In particular for the deficiency of 'automatic wage calculations are not checked' the explanation needed to focus on how system errors may not be identified on a timely basis rather than a generic comment relating to 'an increased risk of fraud and error'.

The last part of the requirement is for candidates to describe control recommendations. To gain the 1 mark available it's imperative that the descriptions of the controls are detailed enough. Additionally, recommendations must be actions rather than just objectives, recommendations which are phrased as 'ensure that....'

are unlikely to gain much credit. Candidates must be sure to describe 'how' something is to be ensured.

Candidates need to take care to ensure that recommendations are well described, clearly address the specific control deficiency identified and are practical suggestions. Many candidates often just repeat the converse of the deficiency, and to obtain the recommendation mark more detail is needed. For the lack of joiner forms deficiency, the recommendation of 'joiner forms should be completed for all new staff member' would only gain $\frac{1}{2}$ marks as candidates need to state who should complete these forms, for example human resources. Additionally for the wages calculations not being checked deficiency, simply recommending that 'a responsible official should recalculate a sample of calculations' was not sufficient as these calculations need to be checked against the payroll system to fully identify whether any system errors have arisen.

Good questions to practice include Pomeranian Co from the 'Sample September/December 2021 Questions', Castle Couriers Co from the 'Sample March/June 2021 Questions', Snowdon Co from the 'Sample March/June 2020 Questions', Amberjack Co from the 'Sample September/December 2019 Questions', and Freesia Co from the 'Sample March/June 2019 Questions'. These are good internal control deficiencies and recommendations questions to practice.

Spinach Co

This 20-mark question is based on Sweetcorn & Co, an audit firm due to commence the audit of Spinach Co, a listed company which manufactures garden furniture. This question tests candidates' knowledge of substantive procedures and auditor's reports.

Requirements (a) and (c) examine substantive procedures for revenue and share capital. Requirement (b) examines audit procedures for inventory counts. Requirement (a) is for 5 marks, (b) for 6 marks and (c) for 4 marks and time allocation should be based on 1.8 minutes per mark. Therefore, the available time should be split as follows; 9 minutes for requirement (a), 11 minutes for (b) and 7 minutes for (c).

One mark is available for each well-explained procedure therefore candidates should aim to produce 5 tests for requirement (a), 6 for (b) and 4 for (c). Candidates must strive to understand substantive procedures and tests of control for part (b) and apply good exam technique. This includes tailoring procedures to the specific requirements of the question. Too often candidates have rote learnt a set of standard tests and these are then produced for each requirement without consideration of their relevance to the scenario provided. This approach tends to generate few marks.

Audit procedures must be sufficiently detailed noting clearly which source document should be used. For example, tests such as 'review disclosures' would only score ½ mark. To score a full mark the procedure should go on to say, 'in accordance with accounting standards/relevant legislation'.

Requirement (a) – 5 marks

AA March/June 2022 (21/22 syllabus)

Symbol Highlighter Stekethrough Calculator Scratch Pad

This scenario relates to five requirements.

It is 1 July 20X5. You are an audit supervisor with Sweetcorn & Co and are responsible for the final audit of your existing client Spinach Co, which is due to commence in September 20X5. Spinach Co is a listed company which manufactures garden furniture. Its draft financial statements for the year ending 31 July 20X5 show revenue of \$65.1m and profit before tax of \$18.2m. The following matters have been brought to your attention:

Revenue
Spinach Co's revenue is generated through sales to individual customers via its website and also to wholesale customers such as garden centres and stores. Price increases in line with inflation were applied across all products in September 20X4. Spinach Co successfully launched three new product lines in February 20X5. Wholesale customers place their orders on credit via Spinach Co's sales ordering department. Individual customers place their order online and immediately pay the full amount owing. The goods are normally dispatched within seven days of the customer placing the order.

Inventory count
Spinach Co is forecasting a year-end inventory balance of \$9.3m. The company undertakes continuous production and full year-end inventory counts will be carried out on 31 July 20X5. Spinach Co's raw materials and finished goods inventory are stored in its six warehouses which are located across the country. The company has one factory site and it is expected that there will be no significant work in progress held at the year-end. Each inventory count will be supervised by a member of Spinach Co's internal audit department. There will be no movements of goods in and out of the warehouses during the counts. Sweetcorn & Co will only attend some of the counts.

The largest warehouse is located at the factory site and around 10% of this warehouse space is rented out to a third-party company, which stores its inventory of cleaning products there. The finance director has explained that the third-party inventory is located in one specific area of the warehouse.

Issue of share capital
The company is looking to expand its operations by securing an additional factory site in January 20X6. In order to raise sufficient capital to fund the factory purchase, Spinach Co issued ordinary shares at a premium in May 20X5, raising a sum of \$4.3m.

(a) Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Spinach Co's revenue. (5 marks)

Paragraph

Help Previous Navigator Next

Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Spinach Co's revenue.

The scenario for this requirement detailed information about how Spinach Co generates sales to its individual customers via its website, and to wholesale customers through the sales ordering department, with the latter sales on credit. Candidates should then consider why this information has been provided and its

relevance. The scenario also details that website sales are paid in full at the point of order and therefore the only receivables would be wholesale customers. The scenario also states that goods are typically dispatched seven days after the date of order. Individual website customers are therefore paying in advance of the dispatch of goods and at the year-end there would be deferred income for any customers who had paid but not had their order dispatched by 31 July. Candidates should then have considered substantive procedures to confirm that the cut off of revenue and deferred income is complete and accurate.

Additionally, the scenario contained information about inflationary sales price increases and new product lines launched in February 20X5. Candidates should spend time understanding this information and then applying it to generate tailored procedures. Analytical procedures are very useful when auditing revenue and can be used to generate several valid tests. Comparisons can be made between total or monthly revenue and the prior year or budget; a breakdown of key product lines or customers can be compared to the prior year as well as a review of the gross margin for the current and prior year. In all cases however, any significant fluctuations must be investigated, not just identified, and discussed with management. Another useful analytical review procedure is a proof in total where the prior year is adjusted for any known fluctuations in the year such as the new product lines, and then compared to the actual revenue in the year with significant fluctuations investigated.

Carefully reading the scenario and question requirement ensures that any procedures listed are tailored and more likely to score marks. Procedures such as casting a breakdown of sales, varied analytical procedures, recalculating sales invoice totals, agreeing sales prices to the authorised price lists and cut-off procedures would all gain credit.

Where the question requirement is for revenue then no credit will be awarded for any receivables procedures. In this session it was common to see candidates stray into receivables tests such as 'reviewing after date cash receipts' and 'considering whether an allowance for receivables was necessary'. Also, where detailed tests were provided, rather than testing to or from the sales day book, incorrect answers focused on the receivables ledger when agreeing to sales invoices and goods dispatched notes (GDNs). This was not valid and so would not have gained the available 1 mark. Additionally, when listing these types of detailed tests, the key point when the sale should be recognised is when the goods have been dispatched and so tests should begin or end with the GDN rather than the sales order.

In this session some candidates focused on whether the inflationary price increases had been appropriately applied and whether this was a reasonable benchmark for increasing prices. This is not a concern of the auditor, but rather for management and so would not have gained credit. Care must also be taken not to produce tests of controls such as 'reviewing the board minutes for evidence of the authorisation of the inflationary price increases', as these are not substantive procedures and would not gain any credit. Many candidates suggested 'reviewing disclosure of revenue' however this would not have gained any credit as revenue, along with most profit or loss account balances, does not require disclosure notes.

When generating substantive procedures, it is important to ensure the tests have sufficient detail and are clear. For example, 'perform a cut off test' without describing what the actual test is and what documents should be used will not gain any marks. It is important to stress that the source document is GDNs before and after the year

end and that these need to be agreed to sales invoices to ensure they have been included in the correct accounting period. If sales invoices had been used as the source document rather than GDNs then only ½ marks would have been awarded.

Requirement (b) – 6 marks

AA March/June 2022 (1122 syllabus)

5 Symbol Highlight Stillwellthrough Calculator Scratch Pad

This scenario relates to five requirements.

It is 1 July 20X5. You are an audit supervisor with Sweetcorn & Co and are responsible for the final audit of your existing client Spinach Co, which is due to commence in September 20X5. Spinach Co is a listed company which manufactures garden furniture. Its draft financial statements for the year ending 31 July 20X5 show revenue of \$65.1m and profit before tax of \$10.2m. The following matters have been brought to your attention:

Revenue
Spinach Co's revenue is generated through sales to individual customers via its website and also to wholesale customers such as garden centres and stores. Price increases in line with inflation were applied across all products in September 20X4. Spinach Co successfully launched three new product lines in February 20X5. Wholesale customers place their orders on credit via Spinach Co's sales ordering department. Individual customers place their order online and immediately pay the full amount owing. The goods are normally dispatched within seven days of the customer placing the order.

Inventory count
Spinach Co is forecasting a year-end inventory balance of \$9.3m. The company undertakes continuous production and full year-end inventory counts will be carried out on 31 July 20X5. Spinach Co's raw materials and finished goods inventory are stored in its six warehouses which are located across the country. The company has one factory site and it is expected that there will be no significant work in progress held at the year end. Each inventory count will be supervised by a member of Spinach Co's internal audit department. There will be no movements of goods in and out of the warehouses during the count. Sweetcorn & Co will only attend some of the counts.

The largest warehouse is located at the factory site and around 10% of this warehouse space is rented out to a third-party company, which stores its inventory of cleaning products there. The finance director has explained that the third-party inventory is located in one specific area of the warehouse.

Issue of share capital
The company is looking to expand its operations by securing an additional factory site in January 20X6. In order to raise sufficient capital to fund the factory purchase, Spinach Co issued ordinary shares at a premium in May 20X5, raising a sum of \$4.3m.

(b) Describe the audit procedures the auditor should perform as part of the audit of Spinach Co BEFORE and DURING the inventory count. (6 marks)

Paragraph

Describe the audit procedures the auditor should perform as part of the audit of Spinach Co BEFORE and DURING the inventory count.

In common with part (a) it is important to carefully consider the requirement and review the scenario to understand what issue is being addressed. In this case the scenario indicated that a full year-end inventory count would be undertaken across the company's six warehouses. In addition, the scenario stressed that there would be no significant work in progress (WIP), that third party inventory is stored at the company's largest warehouse and that there would be no movements of goods in or out of the warehouses during the count.

The requirement strictly focused on procedures both before and during the count and although not required, it would be useful to split the procedures into before and then during the count as this helps to ensure a good cross section of points are covered. Unfortunately, many candidates did not carefully read the requirement and therefore listed procedures which would be undertaken after the count on the final audit e.g. 'reviewing aged inventory records for slowing moving goods' or 'casting inventory records back to the trial balance', these procedures would not gain any credit as they were not addressing the question requirement.

Procedures before the count which will gain credit are those which relate to understanding the risks associated with the various warehouses, as the scenario stated that not all six warehouses would be attended by the auditor. Therefore, reviewing the prior year audit files and discussions with management concerning control issues across the sites would gain credit. In addition, inventory count instructions would need to be reviewed in detail to identify whether any control deficiencies may arise, as these would need to be discussed in advance of the count. Candidates who simply stated 'obtain inventory count instructions' would not have gained credit as simply obtaining them is not undertaking an audit procedure, they need to be reviewed.

Moving onto during the count it is important to consider the role the auditor is undertaking, which is to test whether the controls over the count are functioning correctly, to obtain information for the final audit such as a copy of the completed inventory count sheets, and for the auditor to undertake detailed testing to confirm the completeness and existence of the inventory records. In testing the controls, a key procedure would be to 'observe the counters to ensure the inventory count instructions are being followed correctly'. Having gained credit for this procedure some candidates then laboured this point by listing various elements of the instructions which should be confirmed e.g. 'observe the counters are flagging inventory once counted'. These candidates listed several procedures surrounding the count process which should be confirmed or observed which did not gain any further marks. In addition, many candidates incorrectly provided statements of what controls should be in place within the count, e.g. 'inventory should be counted in teams of two' would not gain credit as this is not an audit procedure.

In this session many candidates did not utilise the scenario correctly. For example, it was stated that WIP was not significant, therefore the auditor would not have focused on auditing this balance, hence no credit was awarded for any WIP procedures. Also, the scenario stated that there was third party inventory stored in one warehouse and so candidates should have focused on confirming controls over the segregation of these goods from the count. However, many candidates instead focused on Spinach Co holding its goods in other third-party warehouses, which was not alluded to in the scenario at all. It is crucial that candidates read the scenario carefully and do not just focus on individual words.

Requirement (c) – 4 marks

AA March/June 2022 (21/22 syllabus)

5 Symbol Highlight Strikethrough Calculator Scratch Pad

This scenario relates to five requirements.

It is 1 July 20X5. You are an audit supervisor with Sweetcorn & Co and are responsible for the final audit of your existing client Spinach Co, which is due to commence in September 20X5. Spinach Co is a listed company which manufactures garden furniture. Its draft financial statements for the year ending 31 July 20X5 show revenue of \$65.1m and profit before tax of \$18.2m. The following matters have been brought to your attention:

Revenue
Spinach Co's revenue is generated through sales to individual customers via its website and also to wholesale customers such as garden centres and stores. Price increases in line with inflation were applied across all products in September 20X4. Spinach Co successfully launched three new product lines in February 20X5. Wholesale customers place their orders on credit via Spinach Co's sales ordering department. Individual customers place their order online and immediately pay the full amount owing. The goods are normally dispatched within seven days of the customer placing the order.

Inventory count
Spinach Co is forecasting a year-end inventory balance of \$9.3m. The company undertakes continuous production and full year-end inventory counts will be carried out on 31 July 20X5. Spinach Co's raw materials and finished goods inventory are stored in its six warehouses which are located across the country. The company has one factory site and it is expected that there will be no significant work in progress held at the year end. Each inventory count will be supervised by a member of Spinach Co's internal audit department. There will be no movements of goods in and out of the warehouses during the counts. Sweetcorn & Co will only attend some of the counts.

The largest warehouse is located at the factory site and around 10% of this warehouse space is rented out to a third-party company, which stores its inventory of cleaning products there. The finance director has explained that the third-party inventory is located in one specific area of the warehouse.

Issue of share capital
The company is looking to expand its operations by securing an additional factory site in January 20X6. In order to raise sufficient capital to fund the factory purchase, Spinach Co issued ordinary shares at a premium in May 20X5, raising a sum of \$4.3m.

(c) Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Spinach Co's issue of share capital. (4 marks)

Paragraph

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Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Spinach Co's issue of share capital.

The scenario for this requirement was short and simply detailed that shares were issued at a premium in May 20X5. The rationale for the share issue was to purchase a factory, however this is irrelevant for the question requirement, which focused on the share issue itself. Focusing on whether the factory was purchased or auditing this purchase in any way would not gain credit as it is not answering the question asked.

In considering where to start, it is useful to consider the accounting for the share issue as this then provides areas to audit. The share issue would have generated cash proceeds and as the issue was at a premium the share capital and share premium accounts would have been credited. Therefore, procedures which 'inspected the cashbook or bank statements for evidence of the share issue proceeds of \$4.3m' would have gained credit. Also, the shares would need to be recorded within share capital at nominal value, therefore 'agreeing the issue of the shares to the share register'. The premium would need to be recorded in the share premium account, hence 'recalculating the split of the proceeds and agreeing to the share capital and share premium accounts' are all procedures would each have gained 1 mark each.

Other straightforward procedures which gained credit included 'reviewing the disclosure of the share issue in the financial statements', 'agreeing the share issue details to relevant documentation such as share issue prospectus' and 'reviewing board minutes to confirm the number of shares issued and the issue price'.

Common incorrect procedures included 'analytical review of the share capital to the prior year' which is pointless as we know the balance has changed over the year. 'Reviewing the board minutes to confirm the issue of shares was authorised' is a test of control and so does not gain credit. 'Obtaining a written representation over the share issue' would also not be relevant as requesting written representation should be restricted to areas where the auditor is relying on management's judgement or there is little independent evidence available. This is not the case with an issue of share capital.

Good examples to also practice are Danube Co from the 'Sample September/December 2021 Questions', Purrfect Co from the 'Sample March/June 2021 Questions', Sagitarrii & Co from the 'Sample September/December 2020 Questions', Encore Co in the 'Sample March/June 2020 Questions', Spadefish Co from the 'Sample September/December 2019 Questions', and Hyacinth Co from the 'Sample March/June 2019 Questions'.

Requirement (d) – 5 marks

AA March/June 2022 (21:22 syllabus)

Symbol Highlight Strikethrough Calculator Scratch Pad

This scenario relates to five requirements.

It is 1 July 20X5. You are an audit supervisor with Sweetcom & Co and are responsible for the final audit of your existing client Spinach Co, which is due to commence in September 20X5. Spinach Co is a listed company which manufactures garden furniture. Its draft financial statements for the year ending 31 July 20X5 show revenue of \$65.1m and profit before tax of \$18.2m. The following matters have been brought to your attention.

Revenue
Spinach Co's revenue is generated through sales to individual customers via its website and also to wholesale customers such as garden centres and stores. Price increases in line with inflation were applied across all products in September 20X4. Spinach Co successfully launched three new product lines in February 20X5. Wholesale customers place their orders on credit via Spinach Co's sales ordering department. Individual customers place their order online and immediately pay the full amount owing. The goods are normally dispatched within seven days of the customer placing the order.

Inventory count
Spinach Co is forecasting a year-end inventory balance of \$9.3m. The company undertakes continuous production and full year-end inventory counts will be carried out on 31 July 20X5. Spinach Co's raw materials and finished goods inventory are stored in its six warehouses which are located across the country. The company has one factory site and it is expected that there will be no significant work in progress held at the year end. Each inventory count will be supervised by a member of Spinach Co's internal audit department. There will be no movements of goods in and out of the warehouses during the counts. Sweetcom & Co will only attend some of the counts.

The largest warehouse is located at the factory site and around 10% of this warehouse space is rented out to a third-party company, which stores its inventory of cleaning products there. The finance director has explained that the third-party inventory is located in one specific area of the warehouse.

Issue of share capital
The company is looking to expand its operations by securing an additional factory site in January 20X6. In order to raise sufficient capital to fund the factory purchase, Spinach Co issued ordinary shares at a premium in May 20X5, raising a sum of \$4.3m.

It is now 12 November 20X5. During the audit of Spinach Co's inventory, the audit team identified five product lines which were very slow moving and concluded that the net realisable value of these goods was below cost. A significant write down of inventory was required in order to comply with IAS 2 Inventories. The audit engagement partner has determined that inventory is now appropriately valued and that this issue should be communicated as a key audit matter (KAM) in accordance with ISA 701 Communicating Key Audit Matters in the Independent Auditor's Report.

(d)(i) Describe the factors which the audit engagement partner would have considered in determining that this issue is a KAM; and

(ii) Describe the content of the KAM section of the auditor's report for Spinach Co.

(5 marks)
(20 marks)

Paragraph

Describe the factors which the audit engagement partner would have considered in determining that [a detailed] issue is a KAM; and describe the content of the KAM section of the auditor's report for Spinach Co.

Although audit reports feature regularly in the AA exam, there are several ways in which they can be tested, and candidates must be prepared for any type of question on audit reports. For this session 5 marks were awarded for the factors to be considered and for the contents of the KAM section.

The starting point with this type of requirement is to consider what knowledge a candidate has with regards to ISA 701 Communicating Key Audit Matters in the Independent Auditor's Report. Knowledge of this standard will help in considering what influences the decision as to whether an issue is a KAM or not. Although the scenario related to the valuation of inventory, knowledge marks could be easily obtained without reference to the scenario.

Candidates should focus on three to four points that the engagement partner would consider. Such as the level of risk relating to this issue, whether it would be reported to those charged with governance, the significance of the matter and the level of judgement required in forming a conclusion on the truth and fairness of this issue.

The next step would be to move onto the content of the KAM section of the audit report. Here candidates should consider reporting WHAT the issue is – that there was a risk over the valuation of inventory. WHY the issue is considered a KAM – due to the fact it was high risk with significant auditor judgement required. HOW the issue was addressed during the audit – with details of audit procedures adopted along with a review of the disclosures. One point for each of these three would have been sufficient to maximise the available marks. The model answer shows the key points which should be included for each of these three.

This session it was pleasing to see that some candidates had revised the area of KAM. These candidates were generally able to consider factors in determining if the issue was a KAM but struggled with the contents. Some candidates incorrectly assumed they needed to attempt to draft the KAM paragraph rather than just describing its content. Other common incorrect answers attempted to answer this

question as if it related to a modified audit opinion. It is important to revise all audit report options and not to simply assume that the focus of the question will contain a modified opinion.

Auditor's reports are a core area of the syllabus and knowledge of the ISAs in this area is imperative. Good questions to practice are Danube Co from the 'Sample September/December 2021 Questions', Purrfect Co from the 'Sample March/June 2021 Questions', Sagitarrii & Co from the 'Sample September/December 2020 Questions', and Encore Co in the 'Sample March/June 2020 Questions'.