Section B

16 (a) Audit risk and the components of audit risk

Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of two main components, being the risk of material misstatement and detection risk. Risk of material misstatement is made up of a further two components, inherent risk and control risk.

Inherent risk is the susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement which could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

Control risk is the risk that a misstatement which could occur in an assertion about a class of transaction, account balance or disclosure and which could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

Detection risk is the risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement which exists and which could be material, either individually or when aggregated with other misstatements. Detection risk is affected by sampling and non-sampling risk.

(b) Audit risks and auditor's responses

Audit risk	Auditor's response
Hurling Co upgraded their website during the year at a cost of \$1·1m. The costs incurred should be correctly allocated between revenue and capital expenditure. As the website has been upgraded, there is a possibility that the new processes and systems may not record data reliably and accurately. This may lead to a risk over completeness and accuracy of data in the underlying accounting records.	Review a breakdown of the costs and agree to invoices to assess the nature of the expenditure and if capital, agree to inclusion within the asset register or agree to the statement of profit or loss. The audit team should document the revised system and undertake tests over the completeness and accuracy of data recorded from the website to the accounting records.
Hurling Co has entered into a transaction to purchase a new warehouse for \$3·2m and it is anticipated that the legal process will be completed by the year end. Only assets which physically exist at the year end should be included in property, plant and equipment. If the transaction has not been completed by the year end, there is a risk that assets are overstated if the company incorrectly includes the warehouse at the year end.	Discuss with management as to whether the warehouse purchase was completed by the year end. If so, inspect legal documents of ownership, such as title deeds ensuring these are dated prior to 1 April 20X7 and are in the company name.
Significant finance has been obtained in the year, as the company has issued \$5m of irredeemable preference shares. This finance needs to be accounted for correctly, with adequate disclosure made. As the preference shares are irredeemable, they should be classified as equity rather than non-current liabilities. Failing to correctly classify the shares could result in understated equity and overstated non-current liabilities.	Review share issue documentation to confirm that the preference shares are irredeemable. Confirm that they have been correctly classified as equity within the accounting records and that total financing proceeds of \$5m were received. In addition, the disclosures for this share issue should be reviewed in detail to ensure compliance with relevant accounting standards.
The finance director has extended the useful lives of fixtures and fittings from three to four years, resulting in the depreciation charge reducing. Under IAS 16 *Property, Plant and Equipment*, useful lives are to be reviewed annually, and if asset lives have genuinely increased, then this change is reasonable. However, there is a risk that this reduction has occurred in order to boost profits. If this is the case, then fixtures and fittings are overvalued and profit overstated.	Discuss with the directors the rationale for any extensions of asset lives and reduction of depreciation rates. Also, the four-year life should be compared to how often these assets are replaced, to assess the useful life of assets.
A customer of Hurling Co has been encountering difficulties paying their outstanding balance of \$1·2m and Hurling Co has agreed to a revised credit period. If the customer is experiencing difficulties, there is an increased risk that the receivable is not recoverable and hence is overvalued.	Review the revised credit terms and identify if any after date cash receipts for this customer have been made. Discuss with the finance director whether he intends to make an allowance for this receivable. If not, review whether any existing allowance for uncollectable accounts is sufficient to cover the amount of this receivable.

Audit risk	Auditor's response
A sales-related bonus scheme has been introduced in the year for sales staff, with a significant number of new customer accounts on favourable credit terms being opened pre year end. This has resulted in a 5% increase in revenue. Sales staff seeking to maximise their current year bonus may result in new accounts being opened from poor credit risks leading to irrecoverable receivables. In addition, there is a risk of sales cut-off errors as new customers could place orders within the two-month introductory period and subsequently return these goods post year end.	Increased sales cut-off testing will be performed along with a review of any post year-end returns as they may indicate cut-off errors. In addition, increased after date cash receipts testing to be undertaken for new customer account receivables.
Hurling Co has halted further sales of its new product Luge and a product recall has been initiated for any goods sold in the last four months. If there are issues with the quality of the Luge product, inventory may be overvalued as its NRV may be below its cost. Additionally, products of Luge sold within the last four months are being recalled, this will result in Hurling Co paying customer refunds. The sale will need to be removed; a refund liability should be recognised along with the reinstatement of inventory, although the NRV of this inventory could be of a minimal value. Failing to account for this correctly could result in overstated revenue and understated liabilities and inventory.	Discuss with the finance director whether any write downs will be made to this product, and what, if any, modifications may be required with regards the quality. Testing should be undertaken to confirm cost and NRV of the Luge products in inventory and that on a line-by-line basis the goods are valued correctly. Review the list of sales made of product Luge prior to the recall, agree that the sale has been removed from revenue and the inventory included. If the refund has not been paid pre year end, agree it is included within current liabilities.
Petanque Co, a customer of Hurling Co, has announced that they intend to commence legal action for a loss of information and profits as a result of the Luge product sold to them. If it is probable that the company will make payment to the customer, a legal provision is required. If the payment is possible rather than probable, a contingent liability disclosure would be necessary. If Hurling Co has not done this, there is a risk over the completeness of any provisions or the necessary disclosure of contingent liabilities.	Caving & Co should write to the company's lawyers to enquire of the existence and likelihood of success of any claim from Petanque Co. The results of this should be used to assess the level of provision or disclosure included in the financial statements.
The finance director has requested that the audit completes one week earlier than normal as he wishes to report results earlier. A reduction in the audit timetable will increase detection risk and place additional pressure on the team in obtaining sufficient and appropriate evidence. In addition, the finance team of Hurling Co will have less time to prepare the financial information leading to an increased risk of errors arising in the financial statements.	The timetable should be confirmed with the finance director. If it is to be reduced, then consideration should be given to performing an interim audit in late March or early April; this would then reduce the pressure on the final audit. The team needs to maintain professional scepticism and be alert to the increased risk of errors occurring.
The company is intending to propose a final dividend once the financial statements are finalised. This amount should not be provided for in the 20X7 financial statements, as the obligation only arises once the dividend is announced, which is post year end. In line with IAS 10 *Events after the Reporting Date* the dividend should only be disclosed. If the dividend is included, this will result in an overstatement of liabilities and understatement of equity.	Discuss the issue with management and confirm that the dividend will not be included within liabilities in the 20X7 financial statements. The financial statements need to be reviewed to ensure that adequate disclosure of the proposed dividend is included.

(c) Ethical threats and safeguards

(i) Ethical threat	(ii) Possible safeguard
The finance director is keen to report Hurling Co's financial results earlier than normal and has asked if the audit can be completed in a shorter time frame. This may create an intimidation threat on the team as they may feel under pressure to cut corners and not raise issues in order to satisfy the deadlines and this could compromise the objectivity of the audit team and quality of audit performed.	The engagement partner should discuss the timing of the audit with the finance director to understand if the audit can commence earlier, so as to ensure adequate time for the team to gather evidence. If this is not possible, the partner should politely inform the finance director that the team will undertake the audit in accordance with all relevant ISAs and quality control procedures. Therefore the audit is unlikely to be completed earlier. If any residual concerns remain or the intimidation threat continues, then Caving & Co may need to consider resigning from the engagement.
A non-executive director (NED) of Hurling Co has just resigned and the directors have asked whether the partners of Caving & Co can assist them in recruiting to fill this vacancy. This represents a self-interest threat as the audit firm cannot undertake the recruitment of members of the board of Hurling Co, especially a NED who will have a key role in overseeing the audit process and audit firm.	Caving & Co is able to assist Hurling Co in that they can undertake roles such as reviewing a shortlist of candidates and reviewing qualifications and suitability. However, the firm must ensure that they are not seen to undertake management decisions and so must not seek out candidates for the position or make the final decision on who is appointed.
The engagement quality control reviewer (EQCR) assigned to Hurling Co was until last year the audit engagement partner. This represents a familiarity threat as the partner will have been associated with Hurling Co for a long period of time and so may not retain professional scepticism and objectivity.	As Hurling Co is a listed company, then the previous audit engagement partner should not be involved in the audit for at least a period of two years. An alternative EQCR should be appointed instead.
Caving & Co provides taxation services, the audit engagement and possibly services related to the recruitment of the NED. There is a potential self-interest or intimidation threat as the total fees could represent a significant proportion of Caving & Co's income and the firm could become overly reliant on Hurling Co, resulting in the firm being less challenging or objective due to fear of losing such a significant client.	Caving & Co should assess whether audit, recruitment and taxation fees would represent more than 15% of gross practice income for two consecutive years. If the recurring fees are likely to exceed 15% of annual practice income this year, additional consideration should be given as to whether the recruitment and taxation services should be undertaken by the firm. In addition, if the fees do exceed 15%, then this should be disclosed to those charged with governance at Hurling Co. If the firm retains all work, it should arrange for a pre-issuance (before the audit opinion is issued) or post-issuance (after the opinion has been issued) review to be undertaken by an external accountant or by a regulatory body.
The finance director has suggested that the audit fee is based on the profit before tax of Hurling Co which constitutes a contingent fee. Contingent fees give rise to a self-interest threat and are prohibited under ACCA's *Code of Ethics and Conduct*. If the audit fee is based on profit, the team may be inclined to ignore audit adjustments which could lead to a reduction in profit.	Caving & Co will not be able to accept contingent fees and should communicate to those charged with governance at Hurling Co that the external audit fee needs to be based on the time spent and levels of skill and experience of the required audit team members.
At today's date, 20% of last year's audit fee is still outstanding and was due for payment three months ago. A self-interest threat can arise if the fees remain outstanding, as Caving & Co may feel pressure to agree to certain accounting adjustments in order to have the previous year and this year's audit fee paid. In addition, outstanding fees could be perceived as a loan to a client which is strictly prohibited.	Caving & Co should discuss with those charged with governance the reasons why the final 20% of last year's fee has not been paid. They should agree a revised payment schedule which will result in the fees being settled before much more work is performed for the current year audit.

17 (a) Trade payables and accruals

- Compare the total trade payables and list of accruals against prior year and investigate any significant differences.
- Select a sample of post year-end payments from the cash book; if they relate to the current year, follow through to the purchase ledger or accruals listing to ensure they are recorded in the correct period.
- Obtain supplier statements and reconcile these to the purchase ledger balances, and investigate any reconciling items.
- Select a sample of payable balances and perform a trade payables' circularisation, follow up any non-replies and any reconciling items between the balance confirmed and the trade payables' balance.
- Review after date invoices and credit notes to ensure no further items need to be accrued.
- Enquire of management their process for identifying goods received but not invoiced or logged in the purchase ledger and ensure that it is reasonable to ensure completeness of payables.

(b) Audit software procedures using computer assisted audit techniques (CAATs)

- The audit team can use audit software to calculate payables days for the year-to-date to compare against the prior year to identify whether payables days have changed in line with trading levels and expectations. If payables days have decreased, this may be an indication that payables are understated.
- Audit software can be used to cast the payables and accruals listings to confirm the completeness and accuracy of trade payables and accruals.
- Audit software can be used to select a representative sample of items for further testing of payables balances.
- Audit software can be utilised to recalculate the accruals for goods received not invoiced at the year end.
- CAATs can be used to undertake cut-off testing by assessing whether the dates of the last GRNs recorded relate to pre year end; and that any with a date of 1 January 20X6 onwards were excluded from trade payables.

(c) Substantive procedures for bank balances

- Obtain a bank confirmation letter from Airsoft Co's bankers for all of its bank accounts.
- Agree all accounts listed on the bank confirmation letter to Airsoft Co's bank reconciliations and the trial balance to ensure completeness of bank balances.
- For all bank accounts, obtain Airsoft Co's bank account reconciliation and cast to ensure arithmetical accuracy.
- Agree the balance per the bank reconciliation to an original year-end bank statement and to the bank confirmation letter.
- Agree the reconciliations balance per the cash book to the year-end cash book.
- Trace all the outstanding lodgements to the pre year-end cash book, post year-end bank statement and also to the paying-in-book pre year end.
- Trace all unpresented cheques through to a pre year-end cash book and post year-end statement. For any unusual amounts or significant delays, obtain explanations from management.
- Examine any old unpresented cheques to assess if they need to be written back into the purchase ledger as they are no longer valid to be presented.
- Review the cash book and bank statements for any unusual items or large transfers around the year end, as this could be evidence of window dressing.
- Examine the bank confirmation letter for details of any security provided by Airsoft Co or any legal right of set-off as this may require disclosure.
- Review the financial statements to ensure that the disclosure of bank balances is complete and accurate.

(d) Substantive procedures for directors' remuneration

- Obtain a schedule of the directors' remuneration, split by salary and bonus paid in December and cast the schedule to ensure accuracy.
- Agree a sample of the individual monthly salary payments and the bonus payment in December to the payroll records.
- Confirm the amount of each bonus paid by agreeing to the cash book and bank statements.
- Review the board minutes to identify whether any additional payments relating to this year have been agreed for any directors.
- Agree the amounts paid per director to board minutes to ensure the sums included are genuine.
- Obtain a written representation from management confirming the completeness of directors' remuneration including the bonus.
- Review the disclosures made regarding the directors' remuneration and assess whether these are in compliance with local legislation.

(e) Key audit matters

Key audit matters (KAM) are those matters which, in the auditor's professional judgement, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

The purpose of including key audit matters in the auditor's report is to help users in understanding the entity, and to provide a basis for the users to discuss with management and those charged with governance about matters relating to the entity and the financial statements. A key part of the definition is that these are the most significant matters. Identifying the most significant matters involves using the auditor's professional judgement.

ISA 701 *Communicating Key Audit Matters in the Independent Auditor's Report* suggests that in determining key audit matters the auditor should take the following into account:

– Areas of higher assessed risk of material misstatement, or significant risks.
– Significant auditor judgements relating to areas in the financial statements which involved significant management judgement.
– The effect on the audit of significant events or transactions which occurred during the period.

The description of each KAM in the Key Audit Matters section of the auditor's report should include a reference to the related disclosures in the financial statements and covers why the matter was considered to be one of most significance in the audit and therefore determined to be a KAM; and how the matter was addressed in the audit.

18 (a) Control activities

Segregation of duties – assignment of roles or responsibilities to ensure the tasks of authorising and recording transactions and maintaining custody of assets are carried out by different people, thereby reducing the risk of fraud and error occurring. For example, the purchase ledger clerk recording invoices onto the purchase ledger, and the finance director authorising the payment of those purchase invoices.

Information processing – controls including application and general IT controls, which ensure the completeness, accuracy and authorisation of information being processed. For example, use of batch control totals when entering transactions into the system.

Authorisation – approval of transactions by a suitably responsible official to ensure transactions are genuine. For example, authorisation by a responsible official of all purchase orders.

Physical controls – restricting access to physical assets as well as computer programs and data files, thereby reducing the risk of theft. For example, cash being stored in a safe which only a limited number of employees are able to access.

Performance reviews – comparison or review of the performance of the business by looking at areas such as budget versus actual results. For example, the review by department heads of monthly results of actual trading to budget and prior year, with analysis of variances.

(b) Equestrian Co deficiencies and controls

Control deficiency	Control recommendation
Physical verification of assets within the non-current asset register has not been undertaken for some time. A current programme has started but is only 15% complete, due to staff shortages. If non-current assets are not physically verified on a regular basis, there is an increased risk of assets being misappropriated or misplaced as there is no check that the assets still exist in their correct location.	Additional resources should be devoted to completing the physical verification of all assets within the register. If any assets cannot be located, they should be written off. Following this full review, on a monthly basis a sample of assets at the sites should be agreed back to the register to confirm existence.
Equestrian Co has experienced significant staff shortages within their internal audit (IA) department. In addition, several members of the current IA team are new to the company. Maintaining an IA department is an important control as it enables senior management to test whether controls are operating effectively within the company. If the team has staff shortages or lack of experience, this reduces the effectiveness of this monitoring control.	Senior management should consider recruiting additional employees to join the IA department. In the interim, employees from other departments, such as finance, could be seconded to IA to assist them with the internal audits, provided these reviews do not cover controls operating in the department where the employees normally work.
During the year, the human resources (HR) department has been busy; therefore the payroll department has set up new joiners to the company. This is a lack of segregation of duties, as employees are able to set up new joiners in the payroll system and process their pay, this leads to an increased risk of fictitious/duplicate employees being set up.	The HR director should as a matter of urgency review the workloads of the department to assess whether other tasks can be reprioritised as payroll should cease to set up new joiners. This role must immediately revert back to HR to undertake. Additionally, a review should be undertaken of all new joiners set up by payroll with agreement to employee files to confirm that all new employees are *bona fide*.

Control deficiency	Control recommendation
The wage rate has been increased by the HR director and notified to the payroll supervisor by email. As payroll can be a significant expense for a business, any decision to increase this should be made by the board as a whole and not just by the HR director. In addition, the notification of the payroll increase was via email and the payroll supervisor was able to make changes to the payroll standing data without further authorisation. This increases the risk of fraud or errors arising within payroll.	All increases of pay should be proposed by the HR department and then formally agreed by the board of directors. Upon agreement of the pay rise, a written notification of the board decision should be sent to the payroll supervisor who enters the revised pay rate into the system. This change should trigger an exception report for the payroll director, and the new rate should not go live until the director has signed off the changes.
New customers undergo a credit check, after which a credit limit is proposed by the sales staff and approved by the sales director, these credit limits are not reviewed after this. Over a period of time it may be that the customers' credit limits have been set too high, leading to irrecoverable debts, or too low, leading to a loss of sales.	Credit limits should continue to be approved by the sales director; however, on a regular basis the sales director should review these limits based on order history and payment record.
High value inventory is stored in a secure location across all nine warehouses and access is via a four digit code, which is common to all sites. As the code is the same across all sites, this significantly increases the risk of fraud. A considerable number of people will be aware of the codes and could access inventory at any of the nine sites.	The access codes for all of the sites should be changed. Each site should have a unique code, known to a small number of senior warehouse employees. These codes should be changed on a regular basis.
Monthly perpetual inventory counts are supposed to be undertaken at each of the nine warehouses, but some of these are outstanding. In order to rely on inventory records for decision making and the year-end financial statements, all lines of inventory must be counted at least once a year, with high value or high turnover items counted more regularly. If the counts are outstanding, some goods may not be counted, and the inventory records may be incorrect.	The programme of perpetual inventory counts should be reviewed for omissions. Any lines which have been missed out should be included in the remaining counts. At the year end, if any lines are identified as having not been counted, the company should organise an additional count to ensure that all items are confirmed to inventory records.
The bank reconciliations are only reviewed by the financial controller if the sum of reconciling items is significant; therefore some reconciliations are not being reviewed. The financial controller relies solely on the accounts clerk's notification that the bank reconciliations require review. The bank reconciliations could contain significant errors, but a low overall amount of reconciling items, as there could be compensating errors which cancel each other out. Bank reconciliations are a key control which reduces the risk of fraud. If they are not reviewed, then this reduces its effectiveness and also results in a lack of assurance that bank reconciliations are being carried out at all or on a timely basis.	The bank reconciliations should be reviewed by the financial controller on a monthly basis, even if the reconciling items are not significant, and he should evidence his review by way of signature on the bank reconciliation.
Invoices are authorised by the finance director, but payment is only made 75 days after receipt of the invoice. There is the risk that Equestrian Co is missing out on early settlement discounts. Also, failing to pay in accordance with the supplier's payment terms can lead to a loss of supplier goodwill as well as the risk that suppliers may refuse to supply goods to the company.	The policy of making payment after 75 days should be reviewed. Consideration should be given to earlier payment if the settlement discounts are sufficient. If not, invoices should be paid in accordance with the supplier's payment terms.

Section B

			Marks available	*Marks awarded*
16	**(a)**	Define audit risk and its components		
		– Audit risk	2	
		– Inherent risk	1	
		– Control risk	1	
		– Detection risk	1	
		Restricted to	4	
	(b)	Audit risks and responses		
		– Capitalisation of website costs	2	
		– Warehouse acquisition	2	
		– Classification of preference shares	2	
		– Appropriateness of asset useful lives	2	
		– Irrecoverable receivable	2	
		– Sales staff bonus scheme	2	
		– Product recall	2	
		– Legal action	2	
		– Audit timetable, increased detection risk	2	
		– Accounting for proposed dividend	2	
		Max 8 issues, 2 marks each	16	
	(c)	Ethical threats and safeguards		
		– Intimidation threat – audit timetable	2	
		– Self-interest threat – recruitment	2	
		– Familiarity threat – EQCR review	2	
		– Self-interest/intimidation threat – fees	2	
		– Self-interest threat – contingent fee	2	
		– Self-interest threat – outstanding fees	2	
		Max 5 issues, 2 marks each	10	
	Total marks		**30**	

			Marks available	Marks awarded
17	**(a)**	**Substantive procedures for completeness of Airsoft Co's payables and accruals**		
		– Compare to prior year and investigate differences	1	
		– Post y/e cash book payments to ledger	1	
		– Supplier statement reconciliations	1	
		– Trade payables circularisation	1	
		– Review after date invoices and credit notes	1	
		– Enquiry of management process for identifying accruals	1	
		Restricted to	4	
	(b)	**Audit software procedures over trade payables and accruals**		
		– Calculate trade payables days	1	
		– Cast the payables and accruals schedule	1	
		– Select sample for circularisation	1	
		– Recalculate accruals	1	
		– Cut-off testing on GRNs	1	
		Restricted to	3	
	(c)	**Substantive procedures in relation to year-end bank balances**		
		– Bank confirmation letter	1	
		– Agree to bank reconciliation and TB	1	
		– Cast bank reconciliations	1	
		– Testing on bank reconciliations (1 mark per relevant procedure)	4	
		– Review cash book and bank statements for window dressing	1	
		– Examine bank letter for evidence of security granted	1	
		– Review financial statement disclosure	1	
		Restricted to	5	
	(d)	**Substantive procedures in relation to directors' remuneration**		
		– Cast schedule of remuneration	1	
		– Agree payments to payroll records	1	
		– Confirm bonus payments to cash book	1	
		– Review board minutes for additional remuneration	1	
		– Review board minutes for approval	1	
		– Obtain written representation confirming completeness	1	
		– Review financial statement disclosure	1	
		Restricted to	3	
	(e)	**Key audit matters**		
		– Definition of KAM	1	
		– Purpose of KAM	1	
		– Significant matters and areas of judgement	1	
		– Examples of KAM	2	
		– KAM disclosure	1	
		Restricted to	5	
	Total marks		**20**	

			Marks available	Marks awarded
18	(a)	**Control activities**		
		– Segregation of duties	1	
		– Information processing	1	
		– Authorisation	1	
		– Physical controls	1	
		– Performance reviews	1	
		Restricted to	**4**	
	(b)	**Control deficiencies and recommendations**		
		– Assets not physically verified	2	
		– Internal audit staff shortages	2	
		– Payroll setting up new staff	2	
		– Lack of approval for wage increase	2	
		– Credit limits not reviewed regularly	2	
		– Inappropriate access to high value inventory	2	
		– Perpetual inventory counts not complete	2	
		– Bank reconciliations not always reviewed	2	
		– Invoices not paid in line with suppliers' terms	2	
		Max 8 issues, 2 marks each	**16**	
	Total marks		**20**	

This commentary has been written to accompany the published sample questions and answers and is written based on the observations of markers. The aim is to provide constructive guidance for future candidates and their tutors, giving insight into what the marking team is looking for, and flagging pitfalls encountered by candidates who sat these questions.

Question 16

This 30-mark question was based on a listed company, Hurling Co, a manufacturer of computer components. This question tested the areas of audit risks and responses, and ethical threats and safeguards.

Part (a) for four marks required candidates to define audit risk and the components of audit risk. This question was generally well answered with the majority of candidates demonstrating a reasonably good knowledge of the area tested.

Up to 1 mark was awarded for each definition of audit risk and its components.

Most candidates correctly identified the three components of audit risk, however, some candidates did not describe the components correctly. For example inherent risk was often described only as 'the risk due to the nature of the business', rather than 'the susceptibility of an account balance or class of transaction to misstatement before related controls'.

In key knowledge areas such as this, candidates must ensure that they are technically accurate in order to score full marks.

Part (b) for sixteen marks required identification and description of eight audit risks from the scenario and the auditor's response to each. Performance on this question was mixed.

Marks were awarded for identification of audit risk (½ marks each), explanation of audit risk (½ marks each) and an appropriate auditor's response to each risk (1 mark each).

The scenario contained more than eight risks so it was pleasing that most candidates planned their time carefully and generally only attempted to list the required number of issues.

Some candidates however included ethical issues from part (c) of the question in their answer to part (b). For example incorrectly stating that the outstanding prior year audit fee was an audit risk rather than recognising that this is an ethical issue which can threaten auditor independence but does not influence the risk of material misstatement in the financial statements.

A number of candidates did not clearly identify and explain certain audit risks from the scenario. For example, some candidates incorrectly noted the issue of a 'new warehouse' could result in 'incorrect allocation of capital and expenses'. However the issue was that the acquisition of the new warehouse may not have been completed by the year end so there is a risk of existence / rights and obligations not transferred.

A large number of candidates are still not **explaining** how each issue could impact on audit risk and therefore were not awarded the ½ mark for explanation. To adequately explain audit risk, candidates need to state the area of the accounts impacted with either an assertion (e.g. cut off, valuation etc.), a reference to under/over/misstated, or a reference to inherent, control or detection risk.

For example, many candidates correctly identified the legal action raised by the customer as an issue (½ mark) but then incorrectly stated the explanation of the risk as this could lead to a loss of customer goodwill /

reputational damage for the company. This is an explanation of the risk from the company's perspective and does not explain how the financial statements are impacted. To gain the second ½ mark candidates need to refer to either that liabilities may be understated if a provision is needed but not included or that the financial statements may be misstated as contingent liability disclosure is required.

Candidate performance in relation to auditor's responses continues to be mixed. While an auditor's response does not have to be a detailed audit procedure, rather an approach the audit team will take to address the identified risk, the responses given were often too weak such as 'discuss with management'. This is not a sufficient response to deal with any identified audit risk and candidates need to be able to use their knowledge of audit procedures to provide a valid response which would adequately address the risk identified.

A minority of candidates discussed business risks and therefore concentrated their responses on what management should do rather than the auditor. For example advising management not to issue irredeemable preference shares and instead to consider alternative forms of finance. This is not a valid response as it does not address the audit risk identified and it is not within the remit of the auditor to provide this type of guidance.

An assessment of audit risk, is a fundamental factor in planning and assessing the risks of an audit of an entity, and this remains a highly examinable area and candidates must ensure that they include adequate question practice as part of their revision of this key topic.

Part (c) for 10 marks required an identification and explanation of five ethical threats faced by the auditor and how these threats should be reduced. Performance in this question was satisfactory.

Marks were awarded for identification of the issue and type of threat (½ marks each), explanation of the threat (½ marks each) and a safeguard to reduce this threat (1 mark each).

Most candidates were able to identify relevant issues from the scenario, however some candidates did not provide the correct category of threat. For example, some candidates incorrectly categorised the contingent audit fee and the outstanding prior year audit fees as intimidation threats rather than self-interest threats. Candidates are reminded that they must be comfortable with the categories of threats and how they arise in line with ACCA's Code of Ethics and Conduct.

Some candidates identified threats where there was not an issue. A frequent misunderstanding being that the tax work resulted in a self-review threat. This was not correct as the tax work undertaken related to tax returns so would not have had an effect on the tax balance in the audited financial statements.

Candidates often did not explain the issues correctly, or in sufficient detail. For example explaining the threat of self-interest resulting from contingent audit fees, as simply that the auditor will not be independent is not sufficient. Candidates needed to comment on the possibility of the auditor ignoring audit adjustments which reduce profits in order to maintain the fee level in order to obtain the explanation ½ mark.

Some candidates thought an issue had to be identified for each of the categories of ethical threats of self-review, self-interest etc. This resulted in them trying to identify a situation from the scenario to fit each of the types of threats. This is not the correct approach to take as it is unlikely that the scenario will be based around one of each of the five ethical threats.

The second part of the question required safeguards to reduce the risks to an acceptable level. A safeguard should be an action not just a statement of the rules. For example to simply state that contingent audit fees should never be accepted is a statement rather than an action and therefore cannot constitute a safeguard. To obtain the 1 mark for a safeguard candidates should have recommended that the firm decline this fee structure and to explain to the client that the audit fee is based on time and risk.

Some responses were too brief or impractical. For example for the threat of outstanding prior year fees, the response given by some candidates was that the auditor should resign. Resignation is an option for auditors, but it is the last resort and was not appropriate for this threat. To obtain the 1 mark for a safeguard, candidates should have recommended that either a revised payment schedule be arranged with the client and or that further work on this year's audit should be delayed until the outstanding audit fee is paid.

Question 17

This 20-mark question was based on a listed company, Airsoft Co, a manufacturer of stationery products. This question tested candidates' knowledge of financial statement assertions and substantive procedures.

Part (a) for four marks required candidates to describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to the completeness of Airsoft Co's trade payables and accruals. Performance on this requirement was disappointing.

One mark was awarded for each well described procedure.

A number of candidates provided procedures which were not relevant to trade payables or accruals. For example many candidates described audit procedures for purchases and inventory. Candidates are reminded to read the question requirement carefully and to ensure that they are answering the question set.

Further, many candidates provided incomplete tests. For example 'obtain supplier statements and agree to the purchase ledger' would only be awarded ½ mark as without reference to reconciliation and the investigation of reconciling items, this test does not offer much assurance to the auditor. Candidates are again reminded to think about the aim of the procedure when they are describing substantive tests.

Some candidates described audit procedures that did not focus on the completeness assertion. For example, agreeing amounts on the goods received not invoiced listing to post year end invoices, will not ensure that all items which should have been accrued at the year end have been included. Candidates are reminded to think carefully about the direction of their procedure when they are tackling completeness and existence testing, and are reminded that financial statement assertions are a key element of the F8 syllabus.

Part (b) for three marks required candidates to describe audit software procedures which could be carried out during the audit of Airsoft Co's trade payables and accruals. Candidates' performance was disappointing. Some candidates did not attempt this question.

Again one mark was awarded for each well described procedure

Although specifically advised not to, some candidate repeated their tests from part (a). For example, many candidates repeated the analytical review procedures in (a) in their answer to part (b). Marks were only awarded once.

Often candidates did not make it clear the procedure related specifically to payables. For example, using audit software to cast the ledger, without making it clear which ledger exactly did not score the full mark.

Some candidates described control rather than substantive procedures. For example, run dummy data to ensure the payables system is operating correctly, would not be awarded any credit as this is an example of test data and not audit software.

Part (c) for five marks required candidates to describe substantive procedures the auditor should perform to obtain sufficient and appropriate evidence in relation to Airsoft Co's year-end bank balance. Again candidates' performance in this area was mixed.

Again, one mark was awarded for each well described procedure.

Candidates who suggested a detailed audit procedure for each line of a standard bank reconciliation performed well on this question, however, some candidate descriptions of the tests were unclear, for example 'trace outstanding lodgements to pre and post year end'. This is another example of an incomplete test as there is no reference to what source documentation is being used to perform this test. When writing substantive procedures candidates are reminded that their procedure should make clear where the information is being drawn from as well as what it is being agreed to.

The scenario noted that Airsoft Co had a bank overdraft of $2.6m. Some candidates therefore described a number of going concern audit procedures. However, this was not relevant as, not only was it not asked for in the question, but the scenario clearly showed the company was profitable, with profit before tax of $16.3m and total assets of $66.8m and there was no indication in the question that funding was an issue. Candidates must ensure that they read the requirement and answer the question as set.

Part (d) for three marks required candidates to describe substantive procedures the auditor should perform to confirm the directors' remuneration included in the financial statements at the year end. The director's remuneration included their salary and a discretionary bonus. Candidates' performance was disappointing

As in parts (a) (b) and (c) tests were often incomplete or were control tests. The most common incomplete test was simply 'review the disclosures' without going on to say 'to ensure compliance with local legislation'. The most common control test being 'review payroll listings to ensure monthly pay is authorised'

The requirement verb for (a) (b) (c) and (d) was to 'describe' therefore sufficient detail was required to score the 1 mark available per procedure. Also candidates must provide enough tests to score the marks and should assume 1 mark per valid procedure. Candidates are reminded that substantive procedures are a core topic area and they must be able to produce relevant detailed procedures.

Part (e) for five marks required candidates to identify a Key Audit Matter (KAM) and explain how the auditor determines and communicates KAM. This was a knowledge-based requirement based on the relatively new standard, ISA 701 Communicating Key Audit Matters in the Independent Auditor's Report. Candidates' performance was very disappointing with some candidates not attempting this requirement.

Candidates often incorrectly described a KAM as an important matter that the auditor would consider at the planning stage of an audit. Candidates are reminded that knowledge of Auditor Reporting and the relevant ISAs is a key area of the F8 syllabus.

Question 18

This 20-mark question was based on Equestrian Co, a manufacturer of smartphones and tablets. This question tested candidates' knowledge of control activities, and control deficiencies and recommendations.

Part (a) was a knowledge-based requirement asking candidates to describe four different types of control activities and for each type to provide an example control a company could implement. Performance was very disappointing. Many candidates did not attempt this requirement.

The first ½ mark was awarded for each type of control activity described and the second ½ mark for a relevant control example.

Few candidates described the five control activities. Segregation of duties and physical controls were the two most common control activities identified. However, most candidates who did identify these two activities only named and did not describe them so were not awarded the first ½ mark. If a candidate identified a control activity correctly they generally gave a relevant example for the second ½ mark.

Part (b) required candidates to identify and explain from the scenario eight deficiencies in Equestrian Co's internal controls and provide a recommendation to address each of these deficiencies. Candidates' performance was mixed.

Internal control questions typically require internal control deficiencies to be identified (½ marks each), explained (½ marks each), and a relevant recommendation to address the control (1 mark). Internal controls questions remain a highly examinable area.

The scenario in the exam contained more issues than were required to be discussed and it was therefore disappointing that some candidates did not identify the required number of issues noted in the question.

In addition some candidates put more than one deficiency as one point in their answer. For example, some candidates identified 'physical verification of assets had not been completed for some time' due to 'internal audit shortages' and ½ mark was awarded for identifying each of these issues (ie 1 mark in total). However when issues are combined in this manner they are often not individually well explained and neither is a separate recommendation noted for each.

In addition, some candidates did not clearly explain the implication of the deficiency. For example if PPE is not regularly physically verified some candidates stated that an incorrect carrying value of PPE could arise. This is not fully explaining the implication of the deficiency, ie that there may be a possible misappropriation of assets or assets included in the register which cannot be verified.

Most candidates were able to provide good recommendations to address the deficiencies. However some of the recommendations were either poorly described, did not clearly address the specific control weakness identified or were impractical suggestions. For example recommending that monthly counts are carried out to address the deficiency that perpetual inventory counts are outstanding for some sites does not remedy the deficiency as monthly counts should already be performed, the issue is that the company is not adhering to their own policy. In addition, many candidates recommended that the company undertake a full year-end count, despite being told in the scenario that this was not an option.