

EXAMINERS' COMMENTS

SUBJECT	SESSION
Auditing	Intermediate Examination - Autumn 2008

General:

Whilst fairly high number of candidates answered the paper to a good pass standard, a significant proportion of candidates who failed to perform adequately, achieved very low marks in the paper. Here we have the chance to discuss traits of Successful candidates and Unsuccessful candidates, which emerged from this examination session.

Successful candidates' interpreted questions correctly suggesting that due attention was given towards understanding the requirements of the question. Answers appeared to be structured, using the question as a framework for the answers and evidence of better planning was clearly observable. Many attempted their strongest question first to get them off to a triumphant start.

In a nutshell, successful candidates tended to adopt a focused approach, enabling them to deal with the varied questions in the time available.

Unsuccessful candidates did not submit specific replies rather tried to answer by making general comments without making the use of appropriate terminologies which resulted in a poor expression. Apparent lack of study and revision was noted. Answers submitted by some of them were extremely brief and lacked any profundity of knowledge of the relevant areas of the syllabus.

Further, most such candidates started to write whatever they knew about the topic without comprehending the requirement of the question while a few appeared to devote more than the required time to the question in hand without keeping in mind that they have to solve the other questions also. Such candidates therefore should endeavour to manage their time better by making sure they have sufficient time to deal with all the questions equally well.

Q.1 (a) This question was primarily a test of candidates' knowledge of auditors' responsibility with regard to the related party transactions based on ISA 550. In this part four marks were assigned for commenting on the audit senior's conclusion as regards verification of related party transactions and identifying the auditor's responsibility. While many candidates were able to obtain full marks available, a significant number performed poorly.

Few candidates did not consider it necessary to give comments while submitted inconspicuous replies without stating whether the conclusion was right or wrong. Candidates were expected to narrate that the auditor should not decide to omit the audit procedures pertaining to related parties simply on the basis of CFO's statement and that the auditor is responsible to perform audit procedures designed to obtain sufficient appropriate audit evidence regarding the identification and disclosure of related parties by the management and as regards the effects of related party transactions that are material to the financial statements. However, he cannot be expected to detect all related party transactions.

- (b) This part tested candidates' knowledge of describing the type of transactions which could identify existence of unidentified related parties based on paragraph 11 of ISA 550. Most candidates answered this satisfactorily while few of them confused it with the procedures required to be carried out for identification of related party transactions.

Q.2 It was a straightforward question based on ISA 580 and required listing of representations that the auditor should obtain from management regarding **fraud**. There was a broad range of marks achieved within the candidate population and many performed very well. However, few candidates conveyed all the elements of the standard representation letter instead of restricting their reply to the explicit requirements of the question.

Q.3 Seemingly, a significant number of candidates found it to be the easiest question. It required explanation of audit sampling, the risks associated with sampling and the factors which could influence the size of sample for tests of controls and tests of details.

In part (a) of the question, successful candidates rightly narrated that audit sampling involves the application of audit procedures to less than 100% of items within a class of transactions or account balances such that all sampling units have a chance of selection. It enables the auditor to obtain and evaluate audit evidence about the selected items for forming a conclusion about the related population. They also pointed out that audit sampling can use either a statistical or a non-statistical approach. However, few of them depleted their valuable time by gratuitously explaining those approaches in detail and in discussing the sample selection methods.

The majority described "Sampling Risk", in brief and rightly so. However, here again many candidates unnecessarily described the "Non Sampling Risk" also.

In part (b) many candidates correctly identified factors influencing sample size for tests of controls and tests of details based on ISA 530. However, many candidates simply mentioned the same factors under both headings while there were few who knew the difference but could not describe it manifestly probably due to poor command of English.

Q.4 This proved to be the most difficult question for the candidates. Their approach in addressing the situation indicating potential going concern uncertainty and the resultant implications on review report of interim financial information left much to be desired. Only few of the candidates tackled the question in a desired order, on the following lines:

- (i) At the outset the auditor should inquire whether the management has changed its assessment of the entity's ability to continue as a going concern.
- (ii) If he concludes that the conditions cast significant doubts about the entity's ability to continue as a going concern, he should:
 - Inquire from the management about their future plans, the feasibility of these plans and whether management believes that the outcome of such plans will improve the situation.
 - Consider the adequacy of the disclosure of such matters in the financial information.
- (iii) The auditor should consider whether the note given by the management adequately discloses the uncertainty.
- (iv) If he assesses that the note is adequate, the auditor should give an emphasis of the matter paragraph, otherwise, he should express a qualified or adverse opinion, as appropriate.

The quality of answers varied a lot. Many candidates scored no marks at all as a consequence of having only superficial knowledge of the subject, profound dependence on memorizing the subject as compared to understanding the substance behind it and lack of satisfactory expression skills.

Q.5 In this question the candidates were required to briefly explain procedures to be performed in case of unusual fluctuations between financial statements of current and previous years. ISA 520 has outlined the following steps in this regard:

- (i) Making inquiries from the management.
- (ii) Corroborating management responses by:
 - comparing them with the auditors understanding of the entity; and
 - other audit evidence available.
- (iii) Consideration of the need to perform other audit procedures if management is unable to provide adequate explanation.

Many candidates answered accordingly and secured full marks. However, few candidates got on to the wrong track and produced irrelevant stuff such as explanation of the term "analytical procedures".

Q.6 This question examined the ability of the candidates to draft appropriate qualification paragraphs for inclusion in the auditors' report based on the given issues. It was noticeable that many candidates either did not attempt this question or simply stated irrelevant matters while many others produced the entire auditor's report and wasted precious time. There were very few replies that could be considered complete and relevant. Most of the answers suffered from one or more of the following discrepancies.

- Whereas the first situation justified a qualified opinion due to disagreement with the management, the second situation should have been dealt with by including an emphasis of the matter paragraph. In many cases, a qualification paragraph was drafted in the second situation also.
- A reference to the concerned note was missing in either case. Since the question had given clear directions that the candidates may assume necessary detail, it would have been appropriate to refer to the notes contained in the financial statements in respect of both the issues. For example the modification paragraph relating to depreciation could have commenced with the words "As more fully explained in Note ABC of the financial statements".
- While referring to the first situation, most of the replies were restricted to stating that depreciation has been short provided. References to the facts that accounting policy being followed was not in accordance with the IFRSs was missing whereas the impact on fixed assets, loss for the year and accumulated loss was not mentioned either.
- In the emphasis of the matter paragraph, only the suit filed by the customer amounting to Rs. 4.6 million was mentioned but quite often the reference to the counter claim filed by the Company was missing.

Q.7 (a) It was a relatively straightforward question based on ISA 505 and many candidates achieved good marks by clearly distinguishing between positive external confirmations and negative external confirmations.

(b) Here the candidates were asked to identify the risks associated with each of the two types of confirmations and necessary steps to be taken by an auditor to avert such risks. This was also answered well. However, few candidates wrote lengthy notes on alternative audit procedures for confirming the balances, to cover the risks, which was not a requirement of the question.

(c) In this part a high number of candidates scored good marks as they were able to list down the circumstances in which it may be appropriate to send negative confirmations and also, the situations where a combination of positive and negative external confirmations may be used in accordance with the guidance provided by ISA 505.

Q.8 Candidates were required to describe matters to be considered by auditor before using report of an expert as enumerated in ISA 620. The guidance provided by ISA is outlined hereunder:

- (i) The auditor should evaluate the professional competence of the expert and in doing so, he should consider:
 - Professional licencing and membership of the expert; and
 - Experience and reputation of the expert.
- (ii) The auditor should also evaluate the objectivity of the experts and the risk that it may have been impaired.

While many candidates displayed a high standard of knowledge on this topic, a large number of answers included spurious points and explanations indicating unsatisfactory preparation for this examination. Some of the candidates got confused and listed the matters to be considered before using work of **another auditor**.

Q.9 In this question the candidates were required to explain the matters to be considered while assessing acceptance and continuance of client relationship and also the need to send a new engagement letter in the case of a recurring audit, based on ISA 220. While a good proportion of answers submitted were concise and correct, it was apparent that few candidates did not bother to understand the exact requirement of the question and drafted a standard engagement letter. Those who may have done so deliberately because they didn't know the answer to the actual question, are advised that such a practice does not benefit them in any way. In fact it results in wastage of time which could otherwise be utilized in improving the answers to other questions.

Q.10 (a) The requirement was relatively straightforward i.e. to distinguish between overall audit strategy and an audit plan and it was encouraging that many candidates achieved good marks. However, a significant number of candidates did not recognize the difference between the two.

Good scripts correctly narrated that overall audit strategy sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan whereas an audit plan is more detailed than the overall audit strategy and includes the nature, timing and extent of audit procedures to be performed by engagement team members in order to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level.

(b) In continuation of the topic in part (a), this part required the candidates to identify the matters which are explained in each of the above i.e. the overall audit strategy and the audit plan. Most of the candidates answered this question to a good standard and were able to quote the various matters as have been discussed in ISA 300. However, few candidates did not consider the concise requirements of the question and also discussed the importance of both the documents, which was not required.