



EXPRESS Notes

ACCA Paper P7 (INT)

Advanced Audit and Assurance

For exams in 2012



theexpgroup.com

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START About Express Notes

We are very pleased that you have downloaded a copy of our Express notes for this paper. We expect that you are keen to get on with the job in hand, so we will keep the introduction brief.

First, we would like to draw your attention to the terms and conditions of usage. It's a condition of printing these notes that you agree to the terms and conditions of usage. These are available to view at www.theexpgroup.com. Essentially, we want to help people get through their exams. If you are a student for the ACCA exams and you are using these notes for yourself only, you will have no problems complying with our fair use policy.

You will however need to get our written permission in advance if you want to use these notes as part of a training programme that you are delivering.

WARNING! These notes are not designed to cover everything in the syllabus!

They are designed to help you assimilate and understand the most important areas for the exam as quickly as possible. If you study from these notes only, you will not have covered everything that is in the ACCA syllabus and study guide for this paper.

Components of an effective study system

On ExP classroom courses, we provide people with the following learning materials:

- The Express notes for that paper
- The ExP recommended course notes / essential text or the ExPedit classroom course notes where we have published our own course notes for that paper
- The ExP recommended exam kit for that paper.
- In addition, we will recommend a study text / complete text from one of the ACCA official publishers, but we do not necessarily give this as part of a classroom course, as we think that it can sometimes slow people down and reduce the time that they are able to spend practising past questions.

ExP classroom course students will also have access to various online support materials, including:

- The unique ExP & Me e-portal, which amongst other things allows "view again" of the classroom course that was actually attended.
- ExPand, our online learning tool and questions and answers database

Everybody in the World has free access to ACCA's own database of past exam questions, answers, syllabus, study guide and examiner's commentaries on past sittings. This can be

an invaluable resource. You can find links to the most useful pages of the ACCA database that are relevant to your study on ExPand at www.theexpgroup.com.

How to get the most from these Express notes

For people on a classroom course, this is how we recommend that you use the suite of learning materials that we provide. This depends where you are in terms of your exam preparation for each paper.

Your stage in study for each paper	These Express notes	Exp recommended course notes, or Expedite notes	Exp recommended exam kit	ACCA online past exams
Prior to study, e.g. deciding which optional papers to take	Skim through the Express notes to get a feel for what's in the syllabus, the "size" of the paper and how much it appeals to you.	Don't use yet	Don't use yet	Have a quick look at the two most recent real ACCA exam papers to get a feel for examiner's style.
At the start of the learning phase	Work through each chapter of the Express notes in detail before you then work through your course notes. Don't try to feel that you have to understand everything – just get an idea for what you are about to study. Don't make any annotations on the Express notes at this stage.	Work through in detail. Review each chapter after class at least once. Make sure that you understand each area reasonably well, but also make sure that you can recall key definitions, concepts, approaches to exam questions, mnemonics, etc.	Nobody passes an exam by what they have studied – we pass exams by being efficient in being able to prove what we know. In other words, you need to have effectively input the knowledge and be effective in the output of what you know. Exam practice is key to this. Try to do at least one past exam question on the learning phase for each major chapter.	Don't use at this stage.

Your stage in study for each paper	These Express notes	ExP recommended course notes, or ExPeditate notes	ExP recommended exam kit	ACCA online past exams
Practice phase	Work through the Express notes again, this time annotating to explain bits that you think are easy and be brave enough to cross out the bits that you are confident you'll remember without reviewing them.	Avoid reading through your notes again. Try to focus on doing past exam questions first and then go back to your course notes/ Express notes if there's something in an answer that you don't understand.	This is your most important tool at this stage. You should aim to have worked through and understood at least two or three questions on each major area of the syllabus. You pass real exams by passing mock exams. Don't be tempted to fall into "passive" revision at this stage (e.g. reading notes or listening to CDs). Passive revision tends to be a waste of time.	Download the two most recent real exam questions and answers. Read through the technical articles written by the examiner. Read through the two most recent examiner's reports in detail. Read through some other older ones. Try to see if there are any recurring criticisms he or she makes. You must avoid these!
The night before the real exam	Read through the Express notes in full. Highlight the bits that you think are important but you think you are most likely to forget.	Unless there are specific bits that you feel you must revise, avoid looking at your course notes. Give up on any areas that you still don't understand. It's too late now.	Don't touch it!	Do a final review of the two most recent examiner's reports for the paper you will be taking tomorrow.
At the door of the exam room before you go in.	Read quickly through the full set of Express notes, focusing on areas you've highlighted, key workings, approaches to exam questions, etc.	Avoid looking at them in detail, especially if the notes are very big. It will scare you.	Leave at home.	Leave at home.

Our Express notes fit into our portfolio of materials as follows:

Express Notes

Provide a base understanding of the most important areas of the syllabus only.



Expedite Notes

Provide a comprehensive coverage of the syllabus and accompany our face to face professional exam courses



Expert Notes

Provide detailed coverage of particular technical areas and are used on our Professional Development and Executive Programmes.

To maximise your chances of success in the exam we recommend you visit www.theexpgroup.com where you will be able to access additional free resources to help you in your studies.



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As well as courses for ACCA and other professional qualifications, our portfolio of expertise covers all areas of financial training ranging from introductory financial awareness courses for non financial staff to high level corporate finance and banking courses for senior executives.

Our expert team has worked with many different audiences around the world ranging from graduate recruits through to senior board level positions.

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KEY TERMINOLOGY

Assurance engagement

The IAASB has provided us with the following definition of an assurance engagement:

“An engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.”

Engagement Framework

The IAASB framework distinguishes between assurance engagements and non-assurance engagements.

Assurance engagements are broken down into:

1. Assurance engagements on historical financial information, which are then subdivided into:
 - (a) Reasonable assurance engagements eg statutory audit; and
 - (b) Limited assurance engagements eg voluntary audit.
2. Assurance engagements on other information such as reviews of
 - VFM audits
 - Key Performance Indicators (KPI)
 - Internal control and systems
 - Due diligence assignments
 - Prospective Financial Information (see separate Express note)

Non-assurance engagements are indicated as including:

- Agreed upon procedures
- Review engagements
- Compilation work

Reasonable assurance engagements on historic financial information

This would be a statutory audit with the work involved needing to be conducted in accordance with ISAs.

Auditor will give an opinion designed to increase the level of confidence for prospective users of the audited financial statements, with moderate to high assurance normally being provided.

Limited assurance engagements on historic financial information

This is more and more being seen as a **possible alternative** to the **statutory audit**. As an example, in the UK there have recently been proposals for the introduction of 'mini' audits for **companies** falling below the **audit exemption** threshold.

Whilst there is currently no statutory requirement for such 'mini audit', a significant and increasing number of companies are requesting limited assurance engagements, on an entirely voluntary basis.

Unlike **reasonable assurance** engagements, where '**positive assurance**' may be given, with **limited assurance** engagements **only 'negative assurance'** is provided.

A limited assurance engagement **involves more limited procedures** than are required for a full statutory audit. In effect, **no opinion** is offered on the **information**, although **some assurance** is provided as to its **reasonableness**, with typical wording being as follows:

"Based on our review, nothing has come to our attention that the accompanying financial statements contain material misstatement."



KEY KNOWLEDGE

Assurance Engagements Other than Audits or Reviews of Historical Information

The **work involved** in such engagements and the **approach required**, may be **similar** in **many respects** to an **audit engagement**, albeit the **context** is **different**.

ISAE 3000 provides **guidance** to practitioners for **such engagements**, the **summarised requirements** for which are as follows:

1. **Ethical requirements** – practitioners should comply with ethical requirements such as ACCA's Code of Ethics and Conduct
2. **Quality control** – the practitioner should implement quality control procedures that are applicable to the individual engagement.
3. **Engagement** – the terms of the engagement should be recorded in an engagement letter, and the practitioner should agree on the terms of engagement with the engaging party.
4. **Planning and obtaining evidence** – the practitioner should plan the engagement so that it will be performed effectively, and should consider materiality and assurance engagement risk, and sufficient appropriate evidence should be obtained on which to base the conclusion.

5. **Reporting** – the assurance report should be in writing and should contain a clear expression of the practitioner's conclusion about the subject matter information.



KEY KNOWLEDGE

Value For Money (VFM) Reviews

VFM **involves** consideration of the three Es:

1. **Economy**
2. **Efficiency**
3. **Effectiveness**

In many countries such reviews **originated** in the public sector and in relation to other '**not-for-profit**' organisations, where **alternative measurements** of **performance** (in the absence of profit) had to be developed in order **to assess** the relative **success** or otherwise of the **organisation**. VFM reviews may **also** of course be requested by **commercial companies** as well.

The vast majority of the knowledge required for this type of engagement is **regarded** by the **P7 examiner** as **assumed knowledge** from your **F8 studies**.



KEY KNOWLEDGE

Key Performance Indicators

KPIs may be seen as a **set of measurements** which focus on those aspects of an **organisation's performance** that are most **critical** for its **continued success**.

Many companies, frequently in response to shareholder expectations, now publish details of their KPIs in their annual report. Such KPIs can perhaps be seen as falling into one of **two main categories**:

1. **Financial** – eg accounting ratios based upon the financial statements
2. **Non-financial** – eg company targets on social and environmental issues

Assurance **approach to** KPIs will require **careful consideration** of:

- The **definition** of the KPI
- The **calculation** method
- The **purpose** of the reporting
- Nature of **evidence** available and **source** of underlying **data**

Possible problems facing the assurance provider will include:

- Lack of precise definitions
- Lack of established systems for the capture and recording of KPI data
- Susceptibility of KPIs to manipulation



KEY KNOWLEDGE

Internal Control and Systems Reviews

This type of work is very closely related to the requirements for auditors to consider the company's internal control systems which is comprehensively covered in F8 and therefore not that likely to feature greatly in P7.



KEY KNOWLEDGE

Due Diligence Assignments

There is very little guidance on this type of engagement.

In an examination situation any question may be in the context of a group audit question, as in practice such task is often commissioned by the potential buyer of a company.

The potential buyer will be seeking to discover information about the target company and gain some assurance as to its reliability.

The assurance provider's procedures are often restricted to making use of analytical review techniques and enquiry as they attempt to verify the management representations made by the target company.

The practitioner may also sometimes be asked to offer practical recommendations regarding the acquisition process.

Chapter 2

Audit Reports



START The Big Picture

The one thing all statutory audits of limited liability companies have in common is that at the end of the day an **independent auditor** has to issue a **report** to the **shareholders** as the owners of the company.

The auditors must **report** their **opinion** in respect of **two main issues**:

1. Whether the financial statements give a **'true and fair view'** (or present fairly in all material respects) the company's financial position and performance, and
2. Whether the financial statements have been **'properly prepared'** in accordance with any relevant professional recommendations and/or statutory provisions.

This is **not** of course a **new topic**, as you should **previously** have **studied** this area in **F8**. At the **P7** stage, it is **almost certain** that any **questions** that you get in this area will be **practical** in nature, with few marks, if any, going for pure knowledge.

Given that the **examiner** has stated that she is **concerned** in the auditing paper with testing candidates' **accounting knowledge**, you must **anticipate** that **scenarios** will include **accounting treatments** whose **acceptability** or **otherwise** you will have to be prepared to **discuss**.

In the old syllabus audit reports were one of the declared favourite topics of the examiner and there was a question every time. The **current examiner** has stated that she

acknowledges the **importance** of this syllabus area, **but** students should **not assume** that there will necessarily **always** be a **question** in this area. Having said that, experience to date shows that there is a better than even chance that you will be faced with such a question in your sitting and this must be seen as a **high priority area**.



KEY TERMINOLOGY

ISA 700 The Auditors Report on Financial Statements identifies the key elements of the auditor's report:

1. Title
2. Addressee
3. Introductory paragraph
4. Statement of responsibilities of management
5. Statement of responsibilities of the auditors
6. Scope paragraph
7. Opinion
8. Auditor's signature
9. Date of report
10. Auditor's address

Modified Audit Reports

The standard audit report may be **modified**, such modification may or may not result in the auditors giving a qualified opinion. It is important to remember that **modification** of the audit report will **only** be **required** if there is some **material** issue.

With a practical type of question always make sure that you **use** any **information** available in the **scenario** to help you **assess materiality** in a sensible way, vague references to the fact that you would 'consider materiality' will **NOT** impress the examiner.

For example, let us say you are given the information that a company's profit before tax (PBT) is \$1,000,000 and that the company has failed to make provision for a known bad debt of \$150,000. **State the obvious** by saying that at 15% of PBT the bad debt is material, in that a standard benchmark would be to consider an item impacting on PBT as being material if it is in the range of 5% to 10% of such PBT.

It is also important when assessing materiality to remember that this must be considered so far as the user and not the preparer of financial statements is concerned. A useful **working definition of materiality** may be taken as

'transactions and other events are likely to be seen as material in the context of a company's financial statements if their omission, misstatement or non-disclosure would matter to a proper understanding of such financial statements on the part of a potential user.'

Modified audit report with unqualified opinion

Sometimes there may be **matters** relating to the financial statements which, whilst **fully and adequately disclosed** within the financial statements, the **auditor** considers worthy of **bringing** to the particular **attention** of **users**.

The auditor achieves this by including in the audit report an additional paragraph known as an '**emphasis of matter**' paragraph. This paragraph will be 'self-contained' and will **NOT** otherwise **impact** on the **standard wording** of an unmodified report.

Key points to remember in relation to the use of such paragraph are:

- it should have **a separate heading**
- it should be positioned **AFTER** the opinion paragraph
- it must be made clear that the **audit opinion is not qualified** and so this paragraph should start with words such as '**Without qualifying our opinion we draw attention to ...**'

Past examiners' reports have indicated that **many candidates** have been **unclear** as to how and when to make proper **use of an emphasis of matter paragraph**. It is **important**, therefore, that you are totally happy with this aspect of audit reports.

Examples of where the use of such paragraph would be appropriate include:

- where there the financial statements have been prepared on a going concern basis, but this is dependent upon some **significant uncertainty which is fully and adequately disclosed** in the notes to the financial statements
- where there is a **material inconsistency** between the **financial statements** and the **Directors' Report** and the adjustment required to remove the inconsistency would need to be made in the Directors' Report but the directors are not prepared to make such adjustment.

Modified audit report with qualified opinion

According to ISA 700, there are two main circumstances which might give rise to the auditors deciding that is necessary for them to qualify their audit opinion:

1. **Limitation on scope** which arises where the auditor has been unable to carry out some audit work which normally they would have expected to perform and/or where the circumstances are such that audit evidence which the auditor would normally expect to be available for some reason does not exist.
2. **Disagreement** exists between the auditors and client management in relation to some aspect of the financial statements.

The type of qualified opinion to be given will depend not just on the circumstances as indicated above, but also on how serious the limitation on scope or disagreement is namely is it:

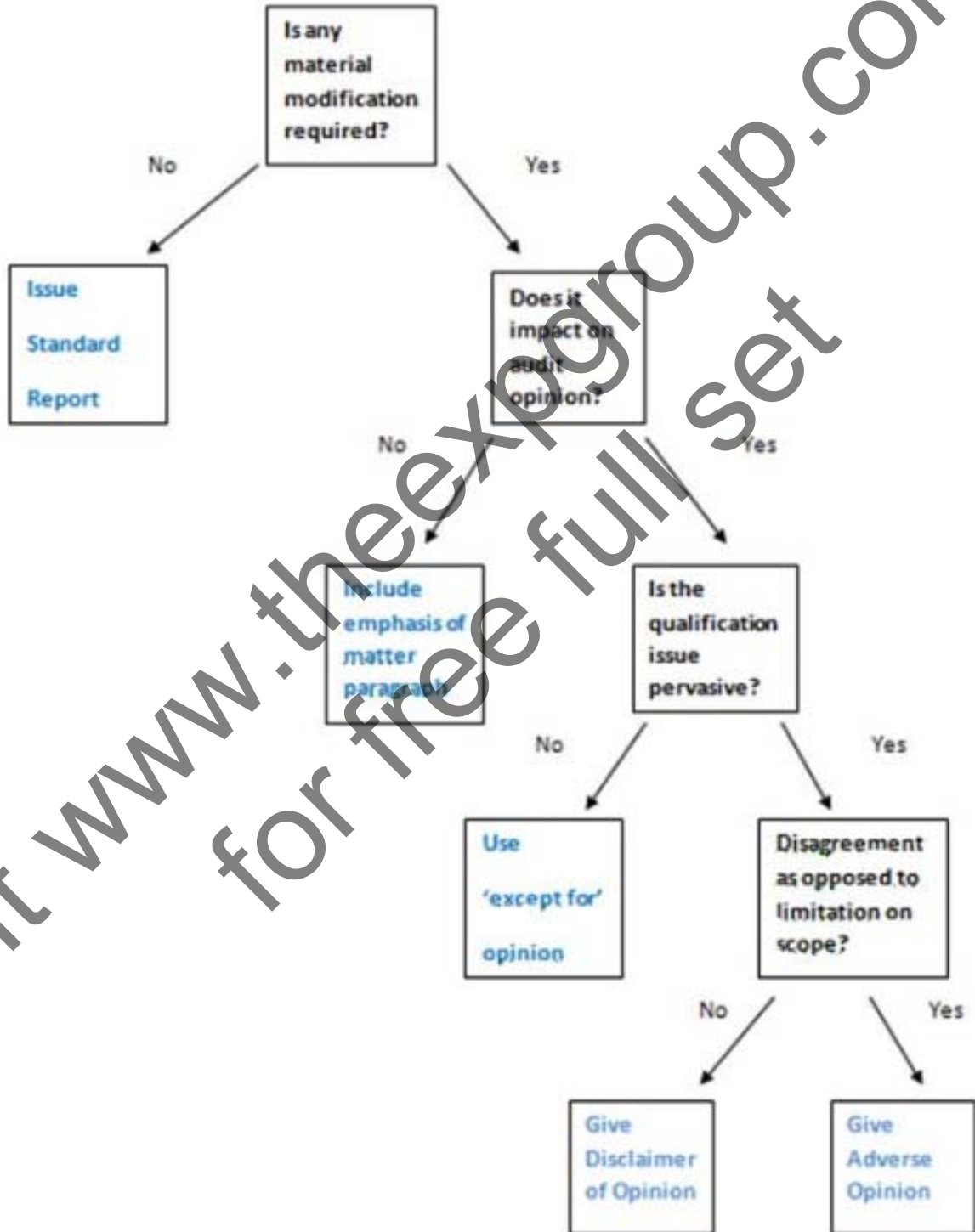
1. **Material but not pervasive**, that is to say that the limitation on scope or disagreement is confined to one particular aspect of the financial statements, such that the auditor is able to say that 'except for' this matter the financial statements give 'a true and fair view etc'.
2. **Material and pervasive**, that is to say that the nature of the limitation on scope or disagreement is such that it will **impact on the overall view given by the financial statements**. In such situation if it is caused by **limitation on scope**, the auditor should give a **Disclaimer of Opinion**, whereas if it is because of **disagreement**, they should give an **Adverse Opinion**.

The circumstances giving rise to a qualified audit opinion should be described in a separate paragraph which appears **BEFORE** the opinion paragraph. Wherever possible, the auditor should **quantify the qualification circumstances** as this should make it easier for the reader to appreciate its significance.



KEY KNOWLEDGE

Summary Diagram of Approach to Practical Audit Report Questions





KEY TERMINOLOGY

AUDIT RISK is very simply the overall risk that the auditor gives an inappropriate audit opinion in his report.

Eg. if an auditor gave an unqualified opinion, when in fact the company was not a going concern, then shareholders and others placing reliance on this report in making economic decisions relating to their dealings with the company might suffer financial loss.

Audit risk is seen as being made up of 3 elements:

AUDIT RISK = INHERENT RISK x CONTROL RISK x DETECTION RISK

The auditor must assess inherent risk and control risk but cannot influence them, they are what they are. The only element which the auditor can influence directly is detection risk, which he must do in order to have overall an acceptable level of audit risk.

Inherent risk is the risk that there may be material errors or misstatements in the client's financial statements, before giving consideration to any internal controls that may have been established.

Eg. in a high tech company there is high risk of obsolete inventory which if not recognised could result in a material overstatement of both profits and asset values.

Control risk is the risk that the client's internal control systems will fail to prevent or detect material errors or misstatements.

Eg. if there is not effective segregation of duties then there is a much higher risk of employee fraud, without the need for collusion, going undetected.

Detection risk is the risk that the auditor's tests and enquiries will fail to detect material errors or misstatements in the transactions and balances reflected in the client's financial statements.

Eg the detection risk is always greater with a new client because the auditors have had less time to build up their knowledge and understanding of the client's business and the risks to which it is exposed.

Detection risk is seen to include the elements of:

1. **Sampling risk** – eg. if the auditor selects too small a sample size, it may not be representative of the population from which it is drawn, resulting in the auditor reaching an invalid conclusion about that population.

2. **Non-sampling risk** – is any other risk that might result in the auditor arriving at the wrong audit conclusion eg. if client management were to deliberately provide the auditor with misleading information and explanations.

From an exam point of view it is important **not** to confuse **audit risk** with **Business Risk**.

Business risk is the risk that a company will fail to meet its strategic objectives or that the policies adopted will be inappropriate. Business risk is to a large extent tied up with the fundamental accounting assumption of **going concern**.

Business risk may also be seen as being made up of 3 main elements:

1. **Operational risk** – eg. shortage of essential raw materials for manufacturing process
2. **Financial risk** – eg. foreign exchange losses when trading internationally
3. **Compliance risk** – eg. payment of fines for breach of anti-pollution legislation

It is important to note carefully the question requirement as to what type of risk you have been asked to consider when analysing a given scenario.

So if the question scenario makes it clear that the company is trading in different currency zones then:

1. **Business risk = foreign exchange losses reduce company's profitability**
2. **Audit risk = overstatement of profit if foreign exchange losses are not properly recognized**

