

# audit and internal review exam technique

## relevant to Professional Scheme Paper 2.6

# applying audit knowledge

■ This article provides some background to the marking of Question 2, Part (a), at the June 2006 session for Paper 2.6. It specifically focuses on some of the common weaknesses that recurred in candidates' scripts.

As in previous diets, the June 2006 Paper 2.6 exam included two relatively detailed questions: audit procedures on a sales system (Question 1), and fixed/non-current assets (Question 2). Such questions are core to this exam because they are based on real audit situations, and therefore allow candidates to demonstrate knowledge of auditing procedures. Unfortunately, many candidates are either unclear about how to apply auditing procedures to a scenario, or do not know how to phrase their comments to show that they understand the subject. The overall result is a decreasing pass rate, as candidates do not obtain pass standards in these core questions. Candidates did obtain higher marks in other questions in the June 2006 paper, noticeably Question 4, where many correctly identified ethical situations and correctly identified the actions required to resolve them. However, the high marks obtained here were insufficient, in many cases, to offset the lower marks obtained in Questions 1 and 2.

### FOCUS ON QUESTION 2

One of the two core questions in the June 2006 paper concerned the audit of railway trucks. The question was a relatively 'standard' auditing question in that candidates needed both knowledge of the auditing procedures required for this area, and then the skill to apply those procedures to the specific situation outlined in the scenario. This type of question has appeared in previous papers and will no doubt feature again in the future. There were two common errors that occurred in many answers:

- Providing general comments on audit procedures without any regard to the detail provided in the scenario. This limited the marks that could be awarded because candidates were not showing how to apply their knowledge. The remedy for this situation was to focus on the audit of railway trucks and not just any fixed/non-current asset.
- Not thinking whether the procedures being applied were actually relevant to the situation outlined in the scenario. Railway trucks were a new category of fixed/non-current asset for the client, so procedures such as checking brought forward balances, or comparing depreciation with that of previous years, had little or no relevance to the audit this year.

**TABLE 1: SCENARIO INFORMATION PROCESS**

Common comment	Weakness	Improvement required	Mark-earning point
Examine board minutes.	It is not clear why the board minutes are being examined.	As railway trucks are a large item, mention authorisation for purchase of trucks.	Examine board minutes authorising the purchase of the trucks.
Cast the ledger and agree to nominal/general.	It is not clear which ledger is being cast or why.	Show that the focus of the answer is on railway trucks, and identify which ledgers are being used.	Cast the fixed/non-current asset ledger; agree total of railway trucks to the nominal/general ledger and financial statements.

Many candidates needed to step back and think for a couple of minutes to see exactly how they would apply the scenario information, and then ensure that their 'standard' list of procedures was actually relevant to this client. Taking time to think would turn many general comments into mark-earning answers. **Table 1** shows this process.

### IMPROVING YOUR ANSWER

**Table 1** (below and opposite) has four columns:

- 1 'Common comment' shows the type of common comment that many candidates made.
- 2 'Weakness' identifies why this is a poor comment.
- 3 'Improvement required' shows how to turn the common comment (earning zero or possibly 0.5 of a mark) into one that obtains a full mark.
- 4 'Mark-earning point' shows the actual content of an answer that would obtain a mark.

Read through **Table 1** to see how general comments can be improved. Note that the table does not show all 'common comments', and is not exhaustive regarding the number of procedures that could be included in an answer.

### CONCLUSION

Hopefully, candidates who did not obtain a pass standard in June 2006 can learn from this guidance, regarding Question 2, Part (a), and can see how to improve their answers. Candidates must be able to demonstrate knowledge and application of auditing procedures in the Paper 2.6 exam, and it is the application that lets many candidates down.

To improve marks, I recommend that candidates practice similar auditing questions, ensuring that the content of answers produced is more like the 'mark-earning point' column than the 'common comment' column. This practice will make application of knowledge easier in the 'real' exam. ■

**Alan Lewin is examiner for Paper 2.6**

Common comment	Weakness	Improvement required	Mark-earning point
Agree the opening balances of railway trucks to last year's closing balances.	The question states that there were no railway trucks last year – new additions this year.	The standard 'opening balances' comment shows that the candidate has not actually considered the scenario information – the comment as it stands is therefore not relevant. Either omit from answer or make relevant.	Discuss with the directors to confirm that railway trucks were a new asset addition this year (verifies that there should be no opening balances).
Agree depreciation rate of railway trucks to last year's financial statements.	This test is not possible – there were no railway trucks last year.	Ensure that the depreciation rate agreed with evidence that is actually obtainable.	Agree depreciation rate chosen by the directors with external evidence such as similar company financial statements. Obtain representation letter confirming that the directors consider the new rate to be appropriate.
Agree assets from register to ensure they physically exist.	As with other points above – it is not clear what is being audited or how the test is being carried out.	State that railway trucks are being audited and that the existence check is being carried out (eg state the trucks are to be seen).	For a sample of assets from the ledger, confirm existence by physically seeing the trucks.
During stock/inventory check, obtain a sample of details of railway trucks and agree back to fixed/non-current asset register to confirm existence of recording of trucks in the ledger.	There is only one word wrong with this statement – the test is actually confirming the completeness assertion – not existence.	State completeness is being tested. In practice, the candidate would obtain some credit for this statement.	During stock/inventory check, obtain a sample of details of railway trucks and agree back to fixed/non-current asset register to confirm completeness of recording of trucks in the ledger.
Ensure that railway trucks have been valued at the lower of cost and net realisable value (NRV).	This statement shows confusion regarding valuation testing. Lower of cost and NRV applies to current assets – not fixed/non-current assets.	Amend the statement to show standard valuation tests for fixed/non-current assets. However, given railway trucks are a new asset, any testing over and above checking that cost less depreciation charge this year = net book value, is probably excessive.	Ensure that net book value of railway trucks is clearly disclosed and the calculation of cost less depreciation this year is correct.
Employ a specialist valuer to ensure that any permanent diminution of value is accounted for in the railway trucks	The test is excessive – trucks have only been purchased this year so any major change in value is unlikely. It is also unlikely that a specialist valuer would be necessary – the cost of trucks is known and the auditor knows how to audit other fixed/non-current assets (eg lorries and motor vehicles) where specialists would not normally be used.	The only way to justify this statement is to link it to the actual physical condition of the railway trucks – ensuring they have not been damaged significantly during their initial use.	
Ensure appropriate disclosure of railway trucks.	Disclosure testing is appropriate, but the statement is at present still very general.	At least state that the Companies Act and/or any relevant FRSs have been followed. Where precise FRSs are known then these should be stated.	Review Companies Act and/or FRSs for relevant disclosure requirements and ensure railway truck disclosure meets those requirements.