



## INDEPENDENT REGULATORY BOARD FOR AUDITORS

### Public Practice Examination November 2010

#### Examiners' comments

This report is compiled from a statistical analysis of the results, as well as from comments received from examiners relating to the performance of candidates in the November 2010 Public Practice Examination (PPE). The report is intended to assist unsuccessful candidates in identifying those areas of competence in which they require further development.

#### STATISTICAL ANALYSIS

##### Annual pass rate

Of the 1952 candidates who wrote the 2010 PPE 1586 passed resulting in a pass rate of 81%. Comparative pass rates for previous years are as follows:

Year	2009	2008	2007	2006
Number of candidates that entered	2798	2566	2479	2451
Number of candidates that passed	2320	1545	1766	1744
Pass Rate	83%	60%	71%	71%

##### 2010 results per attempt

The pass rates per attempt are indicated in the following table.

Candidates	Number that wrote	Number that passed	Pass rate %
First attempt	1495	1306	87%
<b>Repeat</b>			
Second attempt	254	173	68%
Third attempt	106	62	58%
Fourth attempt	54	27	50%
Fifth attempt	43	18	42%
<b>Total</b>			

#### ASSESSMENT OBJECTIVE OF THE PPE

In terms of the examination policy of the IRBA, the objective of the PPE may be stated as follows:

*To assess the professional competence of a candidate to apply integrated knowledge, skills and professional values appropriate to the practice of a Registered Auditor (RA) at entry level to the profession, in a way that will enable the candidate to continue to learn and adapt to change throughout professional life.*

In summary, the aim of the PPE is to assess *professional competence* in the context of the *public practice environment*.

## **Professional competence**

The development of professional competence takes place through an education programme (auditing specialist course) that prepares individuals for entry into the public practice environment. The education programme integrates the core competence gained in the academic programme (Certificate in the Theory of Accountancy (CTA) or equivalent) with practical experience gained in the training programme. This core competence is assessed in the recognised professional qualifying examination (Part 1 of the SAICA Qualifying Examination).

The following six professional competencies embody the expectations of the IRBA of successful candidates of the PPE:

- 1 The ability to apply concepts and principles of a defined technical body of knowledge, skills and professional values in an integrated and analytical manner to complex situations that are likely to be encountered in the multidisciplinary public practice environment.
- 2 The ability to draw on skills developed as a result of practical experience to solve problems related to the function of an RA.
- 3 The ability to apply professional judgement in assessing alternatives and recommending solutions to situations that reflect the public practice environment.
- 4 The ability to communicate effectively by formulating appropriate arguments and recommendations in a concise and logical manner appropriate to the specific user and particular level of assurance required.
- 5 The ability to demonstrate and apply to public practice situations, a comprehensive understanding of the professional values of the profession in general and the ethical requirements specific to the practice of an RA.
- 6 The ability to continue to learn and to adapt to change demonstrating an awareness of current developments shaping the future of the profession.

## **The public practice environment**

When preparing for the PPE, candidates should bear in mind that the context is the public practice environment. This environment is characterised by the following:

- The Auditing Profession Act;
- The Companies Act and other relevant legislation;
- International Standards on Auditing (ISAs);
- International Financial Reporting Standards (IFRS);
- The Disciplinary rules and Code of professional conduct applicable to the accounting profession; and
- The pervasive use of information technology.

It goes without saying that candidates should acquire the necessary technical knowledge, skills and professional values regarding these aspects before attempting the PPE. Candidates should furthermore ensure that they study the required theory that underpins the work of the auditor, and that their knowledge is up to date. They should also bear in mind the cut-off dates for legislation and exposure drafts that are examinable.

## **COMMENTS ON INDIVIDUAL QUESTIONS**

### **QUESTION 1a (51 marks)**

#### **Requirements**

This part of the question required the candidates to:

- Identify and explain instances where the current corporate governance practices set out in the scenario do not comply with the King III Code of Governance Principles.
- Critically evaluate the comments made by an audit manager on various issues raised by the client, mainly related to ethics and legal requirements, pre-engagement activities and independence.
- Describe, with reasons, the effect of the issues raised above will have on the group audit plan...

#### **General comments on interpretation**

In respect to Part 1 (Corporate Governance), most candidates appeared to have interpreted the question correctly – however, most limited their answers to the composition of the committees and did not always address what the various committees should or should not do.

Some candidates in addition only restated aspects from the scenario, without indicating why this was not compliant with King III.

Part 2 did not appear to be misinterpreted, except that several candidates did not provide sufficient detail – for example, candidates identified that the VAT investigation may have been a permitted service, but then did not deal with the detail of pre-engagement activities such as timing, availability of staff, safeguards etc.

Part 3 was answered poorly. Most candidates answered in very general terms without demonstrating that they applied their answers to the scenario. Only a limited number of the candidates identified that the question is testing their knowledge of IAS 600 – they did not interpret or identify it as a “group” audit issue or deal with it by looking at the issues from a group vs component auditor perspective.

There also seems to have been some confusion with candidates between the issues (Part 2) and impact (Part 3). Some candidates were still listing risks and issues in Part 3 or considering the reasons why the comments were inappropriate. Part 3 also included many examples where candidates were repeating answers given in Part 2, instead of indicating how the audit procedures would change or what additional procedures would be required.

Those candidates who interpreted the required with reference to the “audit plan” as defined in ISA 300 fared well as they focused on how it impacts the audit procedures. The majority either repeated the issues listed in Part 2 or just listed general responses.

#### **Major deficiencies relating to examination technique noted**

In Part 2, in particular, several candidates just did not write enough – “critically evaluate” plus “fully motivate” should have been clear guidance to candidates that listing one or two issues is insufficient.

Some cases of very poor handwriting and structure were noted with some candidates. Candidates need to have structure in the way in which they answer a question as they may lose some easy marks due to poorly structured answers. The untidy and sometimes illegible handwriting makes it very difficult for the markers to mark the scripts.

#### **Question 1b (49 marks)**

##### **Requirements**

Candidates were required to:

- Discuss the effect that certain information will have on the assessment of the risk of material misstatement in the 2010 annual financial statements.
- Document, with reasons, the review notes you would raise with the preparer of a specific working paper.

##### **General comments on interpretation**

Section 4 of the required related to the assessment of risk of material misstatement in the annual financial statements. This section the candidates answered very well, and displayed a good understanding of the concepts of risk and the application thereof. The required were also clear and unambiguous.

Section 5 of the required related to the review notes and reasons therefore. The fact that candidates did poorly in this section was not attributed to a lack of knowledge, but to an interpretation problem related to the given information and requirements.

#### **Major deficiencies relating to examination technique noted**

No significant deficiencies relating to examination technique were experienced.

#### **QUESTION 2a (51 marks)**

##### **Requirements**

Candidates were required to:

- Describe the additional key controls, other than physical and logical access controls, that should be implemented to address the following risks:
  - i. Customer data is incorrectly reflected on the rental invoice;
  - ii. Scaffolding delivered to customers do not match those on the rental delivery note; and

- iii. Rental invoices are issued for periods after the rental asset was returned.
- Prepare the required adjusting journal entries relating to the costing of inventory.
- With reference to documents A1 and the “Cash flow forecast for the 12 months ending 30 September 2011”, describe the audit procedures that should be performed to ascertain whether the following items have been included at the appropriate amounts in the forecast:
  - (i) Loan from Aybee Holdings (Pty) Ltd;
  - (ii) Administration costs;
  - (iii) Finance charges; and
  - (iv) Capital expenditure.

### **General comments on interpretation**

Candidates demonstrated some difficulty with Part 1 of the question

- Some candidates produced fairly lengthy and detailed answers to this Part.
- Many candidates appear to have struggled to relate individual controls to the three items examined.
- Many candidates appear to have struggled in deciding where to add detail and how much detail should be added to individual issues
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Candidates’ answers to Part 2 of the Question were disappointing. Whilst most candidates dealt adequately with the first (and more simple) journal entry, many candidates battled to get to grips with the second entry relating to the purchasing variance.

It appears that candidates battled to conceptualise the effect of variances of this nature.

At the same time, there is a solid body of candidates who did very well at answering this part.

### **Major deficiencies relating to examination technique noted**

Some candidates may have had difficulty in managing their time in order to complete the question.

Some candidates had difficulty in applying themselves to Part 1 of the question and/or who provided extensive detail on a limited number of concepts as opposed to limited detail on a wider range of concepts.

## **QUESTION 2b (51 marks)**

### **Requirements**

Candidates were required to:

- Describe the substantive procedures that should be performed to obtain sufficient appropriate audit evidence about the following disclosures in the draft 2010 annual financial statements:
  - (i) the accuracy of the line items “Service cost incurred during the financial year” and “Change in estimates” in note 22.1; and
  - (ii) the principal assumptions in note 22.2
- Describe, with reference to the duties and responsibilities of the auditor, the matters that the auditor should raise in a response to a letter received from a shareholder
- Discuss, with reasons, the impact that the agreement with International Marketing (Pty) Ltd and the material uncertainty regarding going concern will have on the audit report on the 2010 annual financial statements.

### **General comments on interpretation**

The overall view is that the required parts of Question 2B part 4 to 6 were clear and unambiguous, however the candidates did not answer what was required.

Part 4 of the question was, overall, answered well by candidates. Candidates who did not do well in this part of the question usually demonstrated the following:

- Over-complicating the scenario and failing to score easy marks, such as cast and cross cast the schedule, obtain management representation on the accuracy of the provision for estimate, performing analytical procedures etc.
- With regards to the involvement of the actuary, some candidates failed to see this was an expert and that you have to evaluate his competence, experience and independence.

- Some of the candidates who identified that an actuary is an expert just wrote the consideration as they come straight out of the ISAs without the application and writing the audit procedures properly.
- Candidates listed payroll audit procedures which were not required / relevant. E.g. “service costs compared to invoices....”

With regards to Part 5, candidates appear to have not understood the “required”

Candidates discussed King 3 and / or Reportable Irregularities in detail and did not answer what was required. Many candidates only got the “presentation” mark. King 3 and RI discussions were furthermore not applied to the information given- only the theory was documented. Some candidates believe that King III is a legal requirement which of course it is not.

Some candidates addressed disclosure requirements in part 5 (which was not required) instead of part 6.

Many discussions on the protection of minorities (sec 252) were found.

Part 6 required practical experience from the candidates as they were required to form an opinion on the impact of the contraventions of the Companies Act, the RI identified and the disclosure of the going concern.

Candidates confused what is meant when referring to “quantitatively” material. The loan account balance was not discounted by most candidates (95%) to determine if it is material misstated or not. Instead the student took the account balance as stated and compared it to the materiality figure and concluded that it is quantitatively material which was incorrect.

On the going concern section, most of the candidates were of the opinion that the disclosure is adequate when in fact it wasn't. The disclosures of the nature of the uncertainties in the note in the AFS were inadequate to satisfy the requirements of IAS 1.25 As the information did not explicitly draw the readers attention to the possibility that the entity may be unable to continue as a going concern

Again candidates listed the given information in the paper (e.g. going concern indicators were listed which were not required) and discussed theory of the different types of audit opinion without applying it to the question. Candidates “evaluated” and “audited” the going concern issue which was not required.

Some candidates were able to identify that there was a reportable irregularity by contravention on Companies Act and IFRS but only stated the reportable irregularity requirements without application. Candidates wasted time by discussing the theory on RI's e.g. steps to be performed, when and what should be communicated and to whom.

Many candidates identified the contraventions with the Companies Act and did discuss the impact on the audit report however the final overall conclusion for the audit report was not addressed taken into account not only the Companies Act contraventions, but also the loan measurement and the going concern issue. The incorrect conclusion was therefore reached.

Most candidates struggled with the types of audit reports that could be issued. This resulted in candidates losing a lot of easy marks because of their lack of knowledge in this regard.

### **Major deficiencies relating to examination technique noted**

- Poor handwriting
- Writing down theory without applying it to what was required.
- Wording of audit procedures was generally not good – candidates did not say HOW? WHAT? WHY?  
Examples:
  - “Re-perform the work of the expert”... can auditors do that?
  - “Review assumptions used” – how? / Against what? – this is not a proper substantive procedure;
  - “Review the actuary's independence and competence” - How?
  - Compare calculations to “supporting documentation” – What supporting documentation?
  - “Ensure” / “Consider” the actuary's qualifications.... How?
  - Obtain a management representation letter.... (To confirm what and to do what with?)

The reason for the poorly worded audit procedures could be as a result of templates and pre-prepared audit programs being used by trainees and where they do not get the opportunity to formulate procedures in practice.

## **CONCLUDING COMMENTS**

The objective of the PPE is to assess the professional competence of a candidate to apply integrated knowledge, skills and professional values appropriate to the practice of an RA at entry level.

Marks are not awarded for a purely theoretical response to questions. Candidates are required to demonstrate to the examiners that they are able to **apply** a broad range of diverse knowledge and skills to practical situations likely to be encountered in the public practice environment. The overriding reason for being unsuccessful in the 2010 PPE was a failure by candidates to relate their knowledge and skills to the particular scenarios and problems sketched in the questions.