

Examiner's Report

June 2011 Session

Paper 8

**Principles of Auditing and
Management Information Systems**

General Comments

Paper 8 examines candidates on the Principles of Auditing (“Auditing”) and Management Information Systems (“MIS”). The marks allocated between Auditing and MIS is in the ratio of 7:3. The paper is structured in such a way that candidates have to attempt MIS questions to obtain 30 marks out of a total of 100. Despite a weighting of 30% of the total marks, candidates’ performance in MIS questions is always of significance in obtaining a pass.

Candidates should be mindful that ethics and detailed audit procedures have been excluded from the current syllabus. They are expected to have a basic knowledge of controls of major accounting systems, such as authorisation, segregation of duties, completeness and accuracy. With respect to audit objectives, candidates should have knowledge of completeness, accuracy, existence, ownership, valuation, and disclosure.

Candidates performed much better in this examination session and the overall pass rate has improved. Wherever they lost marks, the major reason was their carelessness in reading the requirements of the questions, hence failing to provide correct answers.

Section A – 20 Multiple-choice Questions

Questions were set to cover a wide range of topics on Auditing and MIS within the syllabus. A total of 14 questions were on Auditing and six questions on MIS. Most candidates were able to get 10 marks or more in this section. However, many were not familiar with the following items.

1. The objectives for auditors to carry out a review of financial statements are to ensure that:
 - (i) there is sufficient audit evidence obtained;
 - (ii) the conclusions drawn from the audit evidence obtained do not contradict other audit evidence obtained; and
 - (iii) the audit evidence provides a reasonable basis for auditors to form an opinion on the financial statements.
2. Audit test data, parallel simulation and integrated test facility are commonly used computer auditing techniques, but walk through test is not.
3. Many candidates confused control procedures with output controls. For instance, clerical review of input transactions and validity check are control procedures, while hash totals are output controls.
4. Many candidates did not know that phishing describes the process of sending an email or text message pretending to be a legitimate company.
5. Physical controls, organisational controls, and procedural controls are general controls applied in the IT environment, but internal controls are not general controls.

Section B – 3 Compulsory Questions

The overall performance was good in Questions B1 and B2. However, candidates had not prepared well for Question B3.

Question B1

This question examined candidates’ knowledge of engagement letter. Their overall performance was good.

In part (a), most candidates were able to answer that minimising misunderstanding and recording agreed terms were the purposes of preparing an audit engagement letter. They should also note that an audit engagement letter could also be used as a reference for planning.

Most candidates could give at least six correct answers in part (b).

Question B2

This question examined candidates' understanding of comparisons between internal auditors and external auditors in various aspects. Their overall performance was good.

In part (a), some candidates did not read the requirement carefully, mixing up employment with appointment. They should note that the external auditors were employed by the audit firm, but not by the shareholders.

In part (b), some candidates did not read the requirement carefully again, mixing up reporting line with reporting time.

In part (d), some candidates committed two conceptual mistakes. They thought that the external auditors were required to prepare a set of truly and fairly stated financial statements. Firstly, the external auditors were responsible for giving an opinion on the financial statements, and they were not required to prepare the financial statements. Indeed it should be the management's responsibility to prepare the financial statements. Secondly, the external auditors' opinion was on the truthfulness and fairness of the audited financial statements. It was disappointing to note that some candidates misspelt "true" as "ture". Wrong spelling at this level resulted in deduction of one mark.

In part (e), it was not adequate to answer by merely stating that an external auditor had to be an accountant.

Question B3

This question examined candidates' knowledge of a system development life cycle. The performance was the worst amongst the three questions in Section B. In general, candidates had not prepared well on this topic.

In part (a), many candidates did not understand that a firm had to analyse the shortfall in the existing system and determine the requirements of the new system before proceeding to perform conceptual and physical designs.

In part (b), candidates could not demonstrate their understanding of system analysis, conceptual design and physical design.

Section C – 3 Optional Questions

In this section, the most popular choice was Question C2, while the number of candidates who attempted Questions C1 and C3 were similar. In general, candidates performed well in Question C2, followed by C3 and C1. Many could have obtained higher scores if they were more careful in reading the requirements of each question.

Question C1

This question examined candidates' knowledge of audit programme, audit evidence, selection of specific items for testing, and access controls on computer hardware and software. Many candidates failed to score more than 12 marks because they misinterpreted the requirements of parts (a) and (b).

In part (a), the question did not ask for the type of audit procedures. It asked for the steps in preparing an audit programme. As part of the planning of an audit, auditors are required to prepare audit programmes to facilitate the collection of audit evidence. Auditors have to know the

audit objective to be accomplished. In order to achieve the audit objective, auditors have to determine the audit procedures, items and sample size to be tested, and the timing in conducting the test. For example, if auditors want to test the recoverability of debtors (audit objective), they will decide to select from the balances on the debtors listing (items to select) and check for subsequent settlements (audit procedures). In the preparation of audit programme, auditors will calculate the sample size and determine the coverage of testing. As the auditors are testing on the debtor balances at a particular date, the subsequent settlement test has to be performed after that date, preferably to cover the receipts obtained within a few months after that particular date, not just a few days.

Candidates answered part (b) poorly because their focus was on the reliability of types of audit evidence.

In parts (d) and (e), the first paragraph of the background information clearly stated that auditors might select items for testing either on sampling basis or on specific items. Many candidates did not spot this hint and gave incorrect answers in parts (d) and (e). As selection of items for specific items did not constitute audit sampling, the statistical sampling methods given by the candidates were inappropriate.

In parts (e) and (f), some candidates mixed up the access controls between computer hardware and software.

Question C2

This question examined candidates' knowledge of preliminary estimate of materiality level, audit risk, and the information needs of managers at different levels. Of the three questions in Section C, candidates did the best in this question.

Candidates did not have problem with the definitions in parts (a) and (e). However, some only gave the name of the components of audit risk without defining the components.

In parts (b) and (c), candidates were not aware that preliminary estimate of materiality level could be used to determine the extent of audit evidence to be collected. Also, they did not know that materiality level could be revised throughout the audit as long as the audit evidence obtained could justify a revision.

Candidates performed quite well in part (f), except that some of them wrongly interpreted an invitation to attend the audit client's annual general meeting as a tactical document. As it is not uncommon to receive such invitations from the firm's audit client, the document should be an operational document.

Question C3

This question examined candidates' knowledge of procedures in obtaining an understanding of internal controls, ICQ, types of modified reports, and expert systems. Their overall performance was not satisfactory.

In part (a), many candidates did not read the requirements carefully. The procedures should be related to understanding of internal controls, but some answers were not related to internal controls at all.

It was quite disappointing that candidates could not demonstrate their understanding of ICQ. Many candidates stated that ICQ was composed of "yes" or "no" questions. How can a question be either a "yes" or "no"? It should be the replies to the questions with either a "yes" or "no" answer. Furthermore, only a few candidates could state that ICQ aimed to assess the strengths and weaknesses of internal control, and that a "no" answer might indicate a deficiency in internal control.

In part (c), many candidates failed to note that the inclusion of an emphasis on matter paragraph did not mean the audit opinion was qualified. They failed to notice that the matter being addressed had been appropriately disclosed in the financial statements.

In part (e), candidates failed to note that in operating an expert system, a user had to raise a question with the system to get an answer.

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