

## AAT Paper 8 - Errata Sheet

### Pilot Paper (Page xxxiv to xxxix) – Answers of Pilot Paper B2 and Section C

- B2. (a)** The form and content of audit engagement letters may vary for each client, but the principal contents would generally include:
- (i) The objectives of the audit of financial statements; **[1 mark]**
  - (ii) Management's responsibility for the financial statements, such that directors are responsible for the preparation of financial statements showing a true and fair view; **[1 mark]**
  - (iii) The scope of the audit, including reference to applicable legislation, regulations, or pronouncements of professional bodies to which the auditor adheres; **[1 mark]**
  - (iv) The form of any reports or other communication of results of engagement; **[1 mark]**
  - (v) The fact that because of the nature of test and other inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatement may remain undiscovered; **[1 mark]**
  - (vi) Unrestricted access to whatever records, documentation and other information requested in connection with the audit; and **[1 mark]**
  - (vii) Management's responsibility for establishing and maintaining effective internal control. **[1 mark]**
- (7 marks)**
- (b)** An auditor has a statutory responsibility to report to the members of a company whether in his opinion the financial statements give a true and fair view and whether these financial statements have been properly prepared in accordance with the Companies Ordinance. In arriving at the audit opinion, the auditor is required to consider the following matters, and to report on any in respect of which he is not satisfied:
- (i) whether proper books of account have been kept by the company and proper returns adequate for his audit have been received from branches not visited by him; **[1 mark]**
  - (ii) whether the company's balance sheet and profit and loss account are in agreement with the books of account and returns; and **[1 mark]**
  - (iii) whether he has obtained all the information and explanations which he

considers necessary for the purposes of his audit. **[1 mark]**

In addition, there are certain other matters which, according to the circumstances, may need to be dealt with in the audit report. For example, where the financial statements do not give details of directors' remuneration or of loans to officers, the Companies Ordinance requires an auditor to disclose such matters in his report.

**(3 marks)**

**(Total: 10 marks)**

**B3. (a)** The stages of developing corporate strategy and plans are as follows:

- (i) Establish mission based on the culture and developments in an organization's environment. **[1 mark]**
- (ii) Perform background situation analysis based on results of past activities that contributes to different alternatives. **[1 mark]**
- (iii) Set measurable objectives by converting the results of background situation analysis into company's financial standards and requirements. **[1 mark]**
- (iv) Develop strategies define the long-term ways of achieving the objectives. Information required for developing strategy covers a wide range of subjects, but not in detail. **[1 mark]**
- (v) Develop tactics based on the directions provided by corporate strategy. Tactics are shorter-term ways to achieve success with the strategies. Information required for developing tactics is more detailed and specific than strategic information. **[1 mark]**
- (vi) Develop operational plans for managers of different functional areas. Operational plans are detailed and specific and show the ways that the tactics will be carried out. They define who is responsible for implementing the plan, and when each operation will be completed. **[1 mark]**

**(6 marks)**

**(b)** Information systems contribute to the success of the implementation of corporate strategy in the following respects:

- (i) Provide information to support business processes. **[1 mark]**  
Business processes and activities increasingly rely on the supports provided by information systems. The implementation of corporate strategies involves many changes in business processes within an organization. If business management is to adopt a strategic approach in running their business, then it follows that a strategic perspective must take information systems into account.
- (ii) Initiate changes in business strategies. **[1 mark]**  
The developments in information system can lead to or initiate changes in business strategies because it can provide the needed information for developing and implementing business strategy. Without these strong links, either one of the strategies or both of them may fail.

(iii) Support the process control of strategy implementation. [1 mark]  
In some cases, businesses are evolving their information systems from a supporting role into a proactive use of information technology. In particular, information systems promote the effectiveness and efficiency of strategy implementation by means of providing valuable information and compiling relevant analysis for decision-making, control and monitoring purposes.

(iv) Assist in maintaining competitive strategy. [1 mark]  
When both opportunities and strengths are present, the company is in a position to attack its competitors through the use of information systems so as to have good prospect of success. On the other hand, when threats are faced and where there are weak capabilities, the company must take steps to protect itself from competitors' attacks by strengthening its information system.

**(4 marks)**

**(Total: 10 marks)**

**SECTION C (OPTIONAL QUESTIONS) (50 marks)**

**C1. (a)** Advantages of EIS to the tactical or strategic level decision-makers are:

- (i) EIS does not require decision-makers to have extensive computer experience. Information provided by EIS is presented on user-friendly interfaces or on graphical displays.
- (ii) EIS provides timely delivery of information. Management can make decisions more promptly.
- (iii) EIS provides easy-to-understand information since it filters data for management.
- (iv) EIS offers strong reporting and drill-down capabilities. This helps top-level executives analyse, compare, and highlight trends in important variables so that they can monitor performance and identify opportunities and problems.
- (v) EIS provides information relevant to meeting the strategic goals of the organisation.
- (vi) EIS can facilitate internal communications such as personal correspondence, reports and meetings.
- (vii) EIS can serve as a database for scanning for news on government regulations, competition, financial and economic development and scientific subjects.

**(Any 4 items, 1 mark each, maximum 4 marks)**

- (b) Despite EIS being used extensively by many executives, it has its shortcomings:
- (i) Functions are limited. Cannot perform complex calculations.
  - (ii) Executives may encounter information overload; system may become slow, large, and hard to manage.
  - (iii) Difficult to maintain up-to-date data and this may lead to less reliable and insecure data. Furthermore, the executives often find that after a relatively short period of time, reporting against the original criteria is no longer relevant.
  - (iv) Small companies may encounter excessive costs for implementation.
  - (v) Because executive support systems deal with strategic decisions that are difficult to plan for in advance, it is unusual to find any routine reports being produced on paper.

**(Any 3 items, 1 mark each, maximum 3 marks)**

- (c) Control environment means the overall attitude, awareness and actions [1 mark] of directors and management [1 mark] regarding the internal control system and its importance in the entity. **[1 mark]**

**(3 marks)**

- (d) Control procedures mean those policies and procedures [1 mark] in addition to the control environment which management has established to achieve the entity's specific objectives. [1 mark]

**(2 marks)**

- (e) A strong control environment can significantly complement specific control procedures. [1 mark] However, a strong environment does not, by itself, ensure the effectiveness of the internal control system. [1 mark]

**(2 marks)**

- (f) Factors reflected in the control environment include:

- (i) The function of the board of directors and its committees;
- (ii) Management's philosophy and operating style;
- (iii) The entity's organisational structure and methods of assigning authority and responsibility;
- (iv) Management's control system including the internal audit function, personnel policies and procedures and segregation of duties.

**(Any 3 items, 1 mark each, maximum 3 marks)**

- (g) Determining factors on materiality are:

- (i) Quantitative factors. [1 mark] Materiality is a relative rather than absolute term. Bases are needed for measuring materiality, such as pre-tax profit, total assets, total equity, or total revenue; and
- (ii) Qualitative factors. [1 mark] Such as errors including fraud and irregularities, breach of contractual obligation, change in earning trends etc.

(2 marks)

(h) Audit risk has three components:

- (i) inherent risk; [1 mark]
- (ii) control risk; and [1 mark]
- (iii) detection risk. [1 mark]

“Inherent risk” is the susceptibility of an account balance or class of transactions to misstatement that could be material, individually or when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls. [1 mark]

“Control risk” is the risk that a misstatement could occur in an account balance or class of transactions that could be material, individually or when aggregated with misstatements in other balances or classes, and would not be prevented or detected and corrected on a timely basis by the accounting and internal control systems. [1 mark]

“Detection risk” is the risk that the auditors’ substantive procedures would not detect a misstatement that exists in an account balance or class of transactions that could be material, individually or when aggregated with misstatements in other balances or classes. [1 mark]

(6 marks)

(Total: 25 marks)

C2. (a) Generalizations about the reliability of audit evidence are:

- (i) Audit evidence is more reliable when it is obtained from independent sources outside the entity.
- (ii) Audit evidence that is generated internally is more reliable when the related controls imposed by the entity are effective.
- (iii) Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
- (iv) Audit evidence is more reliable when it exists in documentary form, whether paper, electronic, or other medium (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
- (v) Audit evidence provided by original documents is more reliable than by photocopies or facsimiles.

(Any 4 items, 1 mark each, maximum 4 marks)

(b) Inspection of Tangible Assets

Inspection of tangible assets consists of physical examination of the assets. [1 mark]

Inspection of tangible assets may provide reliable audit evidence with respect to their existence, [1 mark] but not necessarily about the entity's rights and

obligations or the valuation of the assets. **[1 mark]** Inspection of individual inventory items ordinarily accompanies the observation of inventory counting. **(3 marks)**

**(c)** Observation

Observation consists of looking at a process or procedure being performed by others. **[1 mark]** Examples include observation of the counting of inventories by the entity's personnel and observation of the performance of control activities.

Observation provides audit evidence about the performance of a process or procedure, **[1 mark]** but is limited to the point in time at which the observation takes place and by the fact that the act of being observed may affect how the process or procedure is performed. **[1 mark]**

**(3 marks)**

**(d)** Inquiry

Inquiry consists of seeking information of knowledgeable persons, both financial and nonfinancial, throughout the entity or outside the entity. **[1 mark]** Inquiry is an audit procedure that is used extensively throughout the audit and often is complementary to performing other audit procedures. Inquiries may range from formal written to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.

Responses to inquiries may provide the auditors with information not previously possessed or with corroborative audit evidence. **[1 mark]** Alternatively, responses might provide information that differs significantly from other information that the auditors have obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

The auditors perform audit procedures in addition to the use of inquiry to obtain sufficient appropriate audit evidence. Inquiry alone ordinarily does not provide sufficient audit evidence to detect a material misstatement at the assertion level. Moreover, inquiry alone is not sufficient to test the operating effectiveness of controls. **[1 mark]**

**(3 marks)**

**(e)** In determining whether the auditors should use external confirmations to obtain sufficient appropriate audit evidence to support certain financial statement assertions, they would consider the following factors:

- (i) The materiality of the assertions.
- (ii) The assessed level of inherent risk.
- (iii) The assessed level of control risk.
- (iv) The number and size of the individual accounts.
- (v) The effectiveness of confirmation as audit evidence.
- (vi) The availability of other audit evidence.

**(Any 5 items, 1 mark each, maximum 5 marks)**

(f)

	Computer audit procedures	General controls
(i)	Review the documentation of a sample of application systems to determine if systems development and modification policies and procedures are being followed.	(5) Application system acquisitions, development, and maintenance controls <b>[1 mark]</b>
(ii)	Review the CIS department's disaster recovery plan.	(4) System security controls <b>[1 mark]</b>
(iii)	Ask CIS personnel about the types of systems software and whether any modifications have been made to the programs.	(3) Hardware and system software acquisition and maintenance controls <b>[1 mark]</b>
(iv)	Review controls over work flow and error correction procedures.	(2) Data centre and network operations controls <b>[1 mark]</b>
(v)	Review job descriptions of key CIS personnel to ensure that there are no incompatible duties.	(1) Organisational controls <b>[1 mark]</b>

**(5 marks)**

(g) The continuity of the computer operations of a business organization has to be ensured to prevent business disruption or excuse for any financial loss. **[1 mark]**

The control procedures to mitigate this threat include:

- (i) sufficient back up and recovery procedures.
- (ii) offsite storage of data and computer programmes and the storage facility should be secure and housed in a suitable environment to ensure that the archived files are not damaged.
- (iii) enough protection against fire, theft, loss and destruction.
- (iv) alternative processing facilities.

**[Any one item, 1 mark each, maximum 1 mark]**

**(2 marks)**

**(Total: 25 marks)**

- C3. (a)** The auditor's report should state that management is responsible for the preparation and the fair presentation of the financial statements in accordance with the applicable financial reporting framework and that this responsibility includes:
- (i) Designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; **[1 mark]**
  - (ii) Selecting and applying appropriate accounting policies; and **[1 mark]**
  - (iii) Making accounting estimates that are reasonable in the circumstances. **[1 mark]**
- (3 marks)**
- (b)** The auditor's report should state that the audit was conducted in accordance with Hong Kong Standards on Auditing. **[1 mark]** The auditor's report should also explain that those standards require that the auditor comply with ethical requirements **[1 mark]** and that the auditor plan and perform the audit to obtain reasonable assurance **[1 mark]** whether the financial statements are free from material misstatement. **[1 mark]**
- (4 marks)**
- (c)** An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view or are presented fairly, **[1 mark]** in all material respects **[1 mark]**, in accordance with the applicable financial reporting framework. **[1 mark]**
- (3 marks)**
- (d)** The two components forming the aggregate of uncorrected misstatements are:
- (i) Specific misstatements identified by the auditors including the net effect of uncorrected misstatements identified during the audit of previous periods; and **[1 mark]**
  - (ii) The auditors' best estimate of other misstatements which cannot be specifically identified (i.e. projected errors). **[1 mark]**
- (2 marks)**
- (e)** If the aggregate of uncorrected misstatements identified are considered material to the financial statements to ensure that the audit risk can be maintained at a low level, the auditors may consider:
- (i) To extend audit procedures when the uncorrected misstatements are material as compared with the preliminary materiality level, or **[1 mark]**
  - (ii) To request the directors to adjust the financial statements when misstatements are material, or **[1 mark]**
  - (iii) To qualify the audit opinion when misstatements are material. **[1 mark]**
- (3 marks)**

(f) Auditors may not be able to express an unqualified opinion in certain matters. For matters that do affect the auditor's opinion, the auditors may give one of the following opinions:

- (i) Qualified opinion, [1 mark]
- (ii) Disclaimer of opinion, or [1 mark]
- (iii) Adverse opinion. [1 mark]

**(3 marks)**

(g) Knowledge management systems (KMS) are:

- (i) knowledge-based information systems [1 mark]
- (ii) support the creation, organization, and dissemination of business knowledge [1 mark] within the enterprise. [1 mark]

**(3 marks)**

(h) Benefits of knowledge management system (KMS) are as follows:

- (i) Sharing of valuable organizational information.
- (ii) Improved communication among people.
- (iii) Reacting quickly to changes in the internal or external environment.
- (iv) Avoiding re-invention of the wheel, reducing redundant work.
- (v) Retaining intellectual property after the employee leaves, if such knowledge codified.
- (vi) Decreasing staff turnover by lessening employee frustration.
- (vii) Providing consistent service to internal and external customers.
- (viii) Providing employees with potential for increased success, and giving employees more time to be innovative and proactive.

**(Any 2 items, 1 mark each, maximum 2 marks)**

(i) Limitations of knowledge management system (KMS) are as follows:

- (i) Inefficient processes for capturing knowledge  
Organisations are good at capturing basic transaction data and summarising this data for management use. However, data on knowledge can be more difficult to obtain or simply capture but not be adequately cross-referenced.
- (ii) Failure to appreciate the knowledge  
If a knowledge worker is unaware of the existence of this data then it will not be used. Some form of central knowledge registry may be required to keep track of all the organisation's knowledge.

(iii) Difficulty of measuring intangible benefits  
Measuring the costs of implementing a new information system is relatively easy, as they tend to be tangible. However, many of the benefits, especially in the area of increased product quality or better customer service, tend to be intangible. Attributing some value to these benefits may be guesswork and not show the true value of those benefits.

(iv) Information overload  
Care is needed in planning information systems to ensure that only the required “quality” output is produced, rather than producing reports simply because they are available resulting in information overload for the recipient of that information.

**(Any 2 items, 1 mark each, maximum 2 marks)**

**(Total: 25 marks)**

**[ END OF SUGGESTED ANSWERS ]**

## AAT Paper 8 Bibliography

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