

## AUDIT & ASSURANCE

### Diploma stage examination

**7 December 2007**

From 2.00pm to 5.00pm  
plus ten minutes reading time from 1.50pm to 2.00pm

#### ***Instructions to candidates***

*There are **five** questions on this question paper*

*Answer **four** questions in total*

***One compulsory question from Section A***

***Three of the four questions from Section B***

*The question in Section A carries, in total, **40** marks*

*The questions in Section B each carry a total of **20** marks*

*Where a question asks for a specific format or style, such as a letter, report or layout of accounts, marks will be awarded for presentation and written communication.*

## SECTION A (Compulsory)

You are a Senior Internal Audit Manager for Battleship Consortium Services - providing internal audit services to a range of health sector organisations in the North of England.

Five NHS Hospital Trusts have recently appointed you as internal auditors, taking the total number of client organisations, to over 30. The Consortium has arranged an "Introduction to Battleship" day for these new clients, which will be attended by a range of senior and operational managers.

You have received the following e-mail from your line manager:

To: Fran Drake  
From: Philippa Spain  
Date: December 2007  
Subject: Introduction to Battleship - Planning

The date for the meeting to introduce ourselves and our services to our new clients has now been brought forward to 18 December. Unfortunately I'm due to attend a conference in Plymouth all that week, and it would be very expensive to cancel at this late notice. I'd therefore like you to lead our team on the day and you'll therefore have to come up to speed quickly on the planned content and start to prepare your presentations.

I know you haven't previously been involved in these presentations, so I thought it would be useful for me to set out my thoughts on a likely agenda.

I think it's important to start by clearly defining what is our role and the services we provide. My experience in the past is that some operational managers get very confused by the different audit personnel they meet, but this is also an opportunity for us to set out our understanding of management's own responsibilities.

Of course, some confusion may be caused if we are seen as an external source of internal audit. We need to explain the consortium nature of our organisation and promote the advantages that this approach can provide. It might be helpful to reinforce this message by identifying some of the disadvantages that might arise from alternative sources of internal audit, which some of the managers may be familiar with.

Some of the more senior members of staff will be familiar with the formal terms of reference for our services, which have been agreed for their individual Trusts, but you should publicise the general content of such terms of reference to all attending the meeting.

Our audit plan for each Trust is likely to cover a wide range of operational areas and activities, some of which may not have been recently audited. Many of the operational managers will be keen to understand in advance the techniques and methodology we'll be using. Please make sure you allocate some time to a brief description of our systems-based methodology. As part of this session, it might also be useful to discuss with managers the wide range of controls that we typically include in our reviews - it's likely to benefit the organisation if we can get the managers to start thinking about controls well in advance of our visits!

Finally, it's often useful to finish these sessions by publicising that even auditors are not immune from review and assessment of their services. You should confirm to the group that we'll be reporting regularly on our performance so that they can judge our success. It would be useful if you could suggest some performance indicators that can demonstrate our worth to each organisation.

I hope that this gives you a suggested structure to the day. I would be grateful if you could start preparing the content for the presentations. Could you send me some draft notes as soon as possible so that we can finalise the agenda?

Regards  
Philippa

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• **Requirement for question 1**

Prepare notes for the content of the introductory session, which meet the suggestions made by Philippa Spain, including:

- |                                                                                                                                                                   |   |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------|---|
| (a) Define the respective roles and objectives of Internal Audit, External Audit and Management.                                                                  | 8 |
| (b) Explain the consortium approach to provision of internal audit services and identify the expected advantages of this approach.                                | 4 |
| (c) Identify other options for provision of internal audit and describe disadvantages commonly associated with each option.                                       | 6 |
| (d) Identify issues which should be included in formal terms of reference for the internal audit function.                                                        | 5 |
| (e) Explain the systems-based audit methodology and briefly describe the key stages.                                                                              | 4 |
| (f) Identify and illustrate common types of internal control which may be established by management.                                                              | 8 |
| (g) Explain how measures and indicators may be used to assess internal audit performance. Your answer should include specific examples of performance indicators. | 5 |

**(40)**

**SECTION B (Answer three from four questions)**

**2**

There are both similarities and differences in the rights, responsibilities and roles of external audit in the public and private sectors. In addition to the primary objective of providing an opinion on the financial statements, the scope of external audit now extends into a wider range of activities. In the public sector, for example, external auditors have developed additional methodologies to report on performance beyond that based on financial results.

• **Requirement for question 2**

- (a) In addition to the shared objective to form an opinion and report on the financial statements, describe three other attributes shared by external audit in the public and private sectors. 3
- (b) Describe the rights for external auditors in the private sector which are provided by the Companies Act 1985. 4
- (c) Discuss examples of further rights which may be available to external auditors across the public sector. 4
- (d) The most common form of performance reporting in the public sector has been Value for Money (VFM) reporting. Identify the three components of VFM auditing and describe typical criteria used to assess each component. 6
- (e) Describe briefly the current arrangements for value for money auditing in central government, local government and the health sector. 3

**(20)**

3

You are an Audit Manager in a medium sized accountancy firm. Your firm provides audit and associated services to a wide range of clients, in both the private and public sector. You have recently received the following memo from the Partner in charge of new service development:

To: Audit Manager  
From: Partner – New Service Development  
Date: December 2007  
Subject: Marketing new services

I was glad to hear that you have freed up some time to contribute to our marketing activities. It's certainly a busy time for the firm.

Our priorities in the next few weeks are to identify opportunities with our clients where we can extend our services away from the 'standard' audit activities. In particular, the firm is keen to identify whether there is a market for audit-type services which don't assess activities in purely financial terms.

As examples of such activities, I'm aware of other firms providing what they call "social audits" and also "environmental audits". As yet, I don't have a great understanding of what these activities entail and which of our clients would be likely to be interested. My initial thoughts are that the social audit activities might be a good 'fit' with some of our public sector clients. In order to sell these services effectively we need to have a clear understanding of the potential benefits for the client as well, of course, as the potential pitfalls.

In the private sector, as you will probably know, the firm has built up a strong external audit client base from the petrochemical industry, and we may be able to add-on environmental audit services to these clients.

I'm due to make a presentation to the firm's partnership board next week on the viability of developing new services. I'll carry on with some further research myself in other areas, but I don't have time to cover all options. I'd be grateful, therefore, if you could carry out some research on the particular activities mentioned above and summarise your findings in a briefing note that I can then use to plan my presentation.

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- **Requirement for question 3**

Prepare a briefing note as requested by the Partner to cover the following issues:

- (a) Define what is meant by the term “social audit” and describe why the need for social auditing has arisen. 2
- (b) Explain why social auditing may be particularly suited to public sector organisations in general, and explain why an organisation may want to conduct a social audit. 6
- (c) What disadvantages for the organisation may there be in carrying out social audits? 4
- (d) Define what is meant by the term “environmental audit” and describe various aims which such activity may seek to achieve. 4
- (e) Explain why the firm needs to consider environmental matters when completing the external audit of financial statements for its petrochemical industry clients. 4

**(20)**

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# 4

You are a team leader for the internal audit function of a large local authority. You are shortly due to commence a planned audit of the payroll function, using a team comprising yourself as team leader and two junior members of staff. The audit plan allocates 30 days for the review, to be completed by all three members of the team in a two-week period. Both members of your team have been appointed in the last year from accountancy firms with primarily external audit experience to date. Although both team members have completed other internal audit reviews, it is the first payroll review for both of them.

You have already discussed the scope of the review with the Payroll Manager. She has requested that the review specifically provides assurance on the timeliness, authorisation and regularity of payroll transactions.

You plan to carry out a short training session with the team prior to the commencement of the audit. In this session, you wish to highlight the operational objectives discussed with the Payroll Manager which distinguish the internal audit approach from their previous external audit focus. These objectives will be used to agree a work programme for the audit. In addition, you wish to discuss and identify opportunities for the use of substantive analytical procedures which may increase the efficiency of the planned audit.

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- **Requirement for question 4**

Prepare notes for use in your training session to provide the following:

- (a) Prepare a work programme for the internal audit of the payroll function, setting out a suggested detailed control objective, control, test of control and substantive procedure in the following areas:
  - (i) Timeliness 4
  - (ii) Authorisation 4
  - (iii) Regularity 4
- (b) Define analytical procedures and explain the advantages of their use in substantive testing. 4
- (c) Describe four different types of substantive analytical procedures which may be used by auditors. 4

**(20)**

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# 5

You are the Senior Internal Audit Manager in an accountancy firm which has just won the outsourced internal audit contract for the London Borough of Monobridge. Prior to the tendering of this contract, internal audit services were provided by an in-house team.

Your initial assessment of the organisation and the previous internal audit approach has identified that the function had been run on very traditional lines. The previous internal audit team had been staffed by auditors with accountancy qualifications and/or experience. The scope of the audit plan did not change significantly from year to year, and standard audit programmes had also been followed for many years. Audit fieldwork was recorded in manual files.

You have a meeting scheduled with the Director of Finance of the authority to discuss the commencement of your service and the proposed annual internal audit plan. You are keen to demonstrate in this meeting how your firm's approach will differ from the previous in-house arrangements. In particular, you are keen to ensure that both the internal audit plan and the team structure reflects the use and importance of Information Technology (IT) and one of your first reviews is likely to focus on the authority's strategy for IT. In addition, you are aware that the authority is considering further outsourcing opportunities, including proposals to outsource the management of its IT facilities.

You also wish to take the opportunity in this meeting to explain how the internal audit team (both IT specialists and general auditors) might use IT in carrying out their audit activities, and how the authority might benefit from this updated approach.

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- **Requirement for question 5**

Prepare notes in advance of your meeting with the Director of Finance, to cover the following issues:

- (a) Explain why the authority should have a comprehensive IT strategy, and describe the likely components of an effective strategy. 5
- (b) Explain some of the risks that may be faced by an organisation in moving to outsourced facilities management. 5
- (c) Describe the skills required by a specialist IT auditor and provide an example of a typical task that would be carried out by a specialist IT auditor, rather than a general auditor. 5
- (d) Describe typical ways in which general auditors use IT to carry out their audit activities. 5

**(20)**

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