

AUDIT AND ASSURANCE

Diploma stage examination

10 June 2008

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)

1

You are a senior internal audit manager in the Internal Audit section of a large County Council. Your team is responsible for the internal audit reviews carried out in the Social Services Department.

After recent local elections, the Cabinet member responsible for Social Services has changed. The Director of Internal Audit has received the following e-mail from the new member and has asked you to draft an urgent response.

To: HeadofAudit@ACC.gov.uk
From: Jack Dram - Cabinet Member, Social Services
Date: June 2008
Subject: Internal Audit Service

I'm sure you are aware of the personnel changes on the Cabinet - I'm not a man to waste time on pleasantries, so I'm keen to get down to business as soon as possible.

To give you fair warning, I'm keen to have a good look at how your section can contribute to the work of Social Services. My background to date has been in the private sector, as Director of a large group of nursing homes, and we didn't waste time and money on an internal audit service which just poked around telling us what we'd done wrong 10 months ago!

I have had contact, of course, with external auditors. On the whole, these seem to be a fairly focused bunch, clearly concentrating on the financial accounts. And they seem to follow a set routine, with some 'rules' to guide them. I'm not sure so far what the purpose of your section actually is and your work seems to cover a very wide range of activities which I presume your staff can't have much direct experience of. I need you to provide me with an urgent briefing, therefore, which sets out the purpose and scope of your work, and how you differ from the external auditors.

If we have to have you snooping around the Department, it would be useful to work together on frontline activities. I've already identified that the Department gives out an enormous amount of money to both individuals and organisations in grants, for example, to buy equipment and make home alterations for elderly and disabled clients - you know, stair lifts, ramps, new showers, etc. I need some comfort that these payments are actually going to the intended recipients!

Can you let me know as soon as possible how you think you could go about this sort of work? I'm keen to get some benefit out of you as soon as possible.

Regards
Jack Dram

• **Requirement for question 1**

Prepare a draft response to the e-mail from Jack Dram, which includes the following requirements:

- (a) Define the respective objectives of internal and external audit. 4
- (b) Describe the structure, role, and activities of the Auditing Practices Board which regulates the practice of external audit in the UK. 9
- (c) Identify the key principles derived from the APB Auditing Guideline 308 "Evidence for Internal Auditors", which CIPFA's "Statement of Professional Practice on Auditing" requires members working as internal auditors to comply with. 6
- (d) Analyse how the audit of operational systems differs from the audit of financial systems. 4
- (e) Prepare a proposed work programme for the internal audit review of the grants system which identifies:
 - (i) Appropriate objectives of the system. 4
 - (ii) Risk factors which may mean that these objectives are not achieved. 4
 - (iii) Possible controls to address the risks identified. 4
 - (iv) Appropriate tests of the controls identified. 4

1 mark for presentation, format and appropriate tone

(40)

SECTION B (Answer three from four questions)

2

You are the Senior Manager in the Audit Services section of Swan and Clifford, an accountancy and professional services firm. Your firm provides a range of external audit, internal audit and related services to a wide range of mainly public sector clients. You have recently met with the head of training from your firm's Human Resources Team. The head of training is keen to include your section's requirements in her Training Strategy for 2008.

You are particularly concerned that the training plan for your section should include provision of training for some of the 'softer skills' required by your staff in their audit work, as well as more technical training. In particular, you recognise that significant reliance is placed on staff to carry out effective interviews, for differing purposes and at different stages of audit work.

You have agreed to meet the head of training in a week's time to discuss more detailed requirements with her, and she has requested that you provide some notes in advance on the range of work carried out by your section, in order for her to understand these requirements.

• **Requirement for question 2**

Prepare notes for the head of training to explain the following activities:

- | | |
|--|---|
| (a) Identify the aims of pre-audit interviews, which are often crucial to establish or initiate a good working relationship with the auditee. | 5 |
| (b) Explain the purpose of the different types of interview, typically undertaken whilst an audit is in progress. | 3 |
| (c) Identify why particular care must be taken when interviewing personnel as part of a fraud investigation, and what arrangements the auditor might make to ensure that this care is maintained. | 6 |
| (d) Describe how auditors should assess the standard of evidence gathered during audit work. Your notes should include appropriate reference to both the qualitative and quantitative aspects of evidence. | 6 |

(20)

3

Over the years, the purpose and scope of audit has evolved. Organisations, in both public and private sectors, are required to report on their performance in a number of ways, in order to be held accountable for their activities.

This growth and widening of accountability has, in turn, increased the expectation of independent scrutiny of the accountability processes. These developments have increased the profile of auditors and wider inspection regimes.

• **Requirement for question 3**

- (a) A statutory and regulatory framework exists which requires organisations in both public and private sectors to report on their corporate governance.
- (i) Define what is meant by 'corporate governance'. 1
- (ii) Statements of Internal Control are published by organisations in both sectors as part of their corporate governance reporting. Explain, in general terms, what such statements should disclose. 5
- (b) Identify and distinguish between the roles of internal and external audit with regard to corporate governance. 5
- (c) Discuss, with examples from the public sector where appropriate, the implications of the widened scope of audit and inspection for auditors in the following respects:
- (i) Relationships between review agencies. 3
- (ii) Appropriateness of audit involvement. 3
- (iii) Skills and experience of auditors. 3

(20)

4

There are risks associated with the use of Information Technology (IT) in organisations which are mitigated by a wide range of controls. Systems development controls, for example, refer to the arrangements by which computer applications are developed or acquired, implemented and maintained.

• **Requirement for question 4**

- (a) Identify the main aims of systems development controls. 3
- (b) Explain the arguments for auditor involvement at the development stage of new systems. 3
- (c) Identify procedures and controls which an auditor could review at each of the following stages of systems development:
 - (i) Project initiation. 3
 - (ii) Testing and implementation. 3
 - (iii) Post implementation review. 3
- (d) Describe and provide an example of the **two** main types of computer fraud, and explain how effective controls may be in preventing and detecting such frauds. 5

(20)

5

The processes of planning, controlling and recording activity must be effectively managed in audit teams to ensure that a high quality service is delivered. In addition, audit managers must manage the risks inherent in the audit process.

• **Requirement for question 5**

- (a) Define what is meant by overall audit risk, and explain an auditor's general aim in seeking to manage this risk. 2
- (b) Audit risk is made up of three components:
- (i) Define the 'inherent risk' component of audit risk and provide examples of factors present in an organisation which may increase this risk. 3
- (ii) Define the 'control risk' component of audit risk and provide examples of factors present in an organisation which may increase this risk. 3
- (iii) Define the 'detection risk' component of audit risk and explain how the assessment of the other two components is used to manage this risk. 3
- (c) Prepare a list of typical audit management tasks which control audit fieldwork to ensure that both the quantity and the quality of work are achieved against what has been planned. 5
- (d) Assess what audit management actions may be useful to 'debrief' after audit work has been completed i.e. how management might review work in order to continually improve audit procedures. 4

(20)