

AUDIT AND ASSURANCE

Diploma stage examination

9 June 2006

MARKING SCHEME

NOTE: In all cases marks will be awarded to appropriate answers even if not directly covered by the marking scheme

Question 1

(a) Main advantages and potential costs of consortium arrangements in this case:

- Potential reduction in overheads and total costs of IA for all.
- Larger staff base allowing for greater staff satisfaction eg career progression.
- Also greater opportunity for specialisation eg IT audit leading to improvement in quality.
- Opportunity for comparing best practice in different organisations.
- Complexity of funding/budgeting arrangements.
- Allocation of resources to client bodies.

1 mark per point made up to a maximum of 6

(b) Terms of reference for new IA:

- To provide a professional, modern internal audit service to all consortium members.
- To exercise an independent, objective appraisal function.
- Includes ability to report direct to audit committee/senior management.
- Act as a service to management – ie primary responsibility rests with management.
- Main function is to appraise, review and report upon the effectiveness of the systems of internal control.
- Assist management in ensuring that staff comply with procedures.
- Advisory role – involvement with new and developing systems.
- Fraud role – assisting management in prevention and detection; investigation.
- Safeguarding assets and helping promote VFM/Best Value.
- Methodology used – eg Risk based planning; use of specialist audit staff; use of IT to enhance audit.
- Method of allocating resources – effective use of own resources; risk based planning; liaison with EA.
- To secure a proportionate contribution towards the cost of the consortium from all members.
- To allocate audit resources to consortium members on an agreed and reasonable basis.

1 mark per point made up to a maximum of 10

(c) Respective roles of IA, EA and management – Managed Audit

IA – Provision of advice and assurance to management on effectiveness of internal controls.

EA – forming independent opinion of truth and fairness of financial statements.

Management – Primary responsibility for all aspects of corporate performance.

Managed audit benefits include:

- IA – More resources from management in response to better service provided.
- IA – Benefit from EA experience in audit techniques/other organisations' practice.
- EA – Better and more information from management to make audit easier.
- EA – More reliance placed on IA to improve efficiency of audits.
- Mgt. – More value to business provided by more efficient IA.
- Mgt. – more time for EA to provide more services/cheaper audit fees.

1 mark per point made up to a maximum of 8

(d) Requirements for IA in other public service sectors/private sector:

- No compulsory requirement for IA in private sectors.
- All other sectors of public services must have IA function eg HM Treasury for central government departments and agencies/NDPBs.
- However organisations are free to choose how this is provided eg in-house; agency etc.
- Large and well developed market in private audit firms providing IA services in all sectors.
- Possible scope exists for selling services to other public sector organisations.
- However, health sector likely to remain best source owing to sector expertise.

1 mark per point made up to a maximum of 6

(e) PIs for internal audit:

- Audit time; eg actual vs. budgeted timescales for reports.
- Audit cost; eg staff cost per report produced.
- Audit plans; eg planned vs. actual reports produced.
- Staff and skill levels; eg number/percentage of staff qualified/under training.
- Findings and recommendations; eg percentage accepted by management.
- Client reaction; eg customer satisfaction with service provided.
- Reviews by other agencies eg extent of reliance by EA.
- Indicators used should be kept under regular review to ensure continued relevance and usefulness.

1 mark per point made up to a maximum of 8

Up to 2 marks for format and presentation

(40)

Question 2

(a) Tests of control and substantive procedures:

- Tests of control seek to provide audit evidence that internal control procedures are being applied properly ie is the control working
- Output may be correct but control may still have failed to operate properly
- Substantive procedures are carried out to establish directly whether system objectives are being achieved or not ie is the output correct
- If controls are operating properly, auditors may reduce level of substantive procedures necessary to provide opinion on adequacy of output

1 mark per point made up to a maximum of 4

(b) NB Answers to this section are indicative only and marks will be awarded for other, appropriate tests:

CONTROL	TEST OF CONTROL
Asset managers submit form RM001 with details of requirements and Estates Management Supervisor logs all requests submitted in job control book and reconciles on a weekly basis.	Review job control book for evidence of reconciliation and reperform reconciliation for a number of periods.
All authority premises allocated unique reference code and Estates Management Supervisor checks details from RM001 to approved list.	Review approved list to ensure details are up to date and complete.
All staff required to submit weekly timesheet showing time spent against property reference.	Inspect sample of weekly timesheets to ensure all references are complete and accurate.
Supervisor reviews progress of jobs against deadline on a weekly basis.	Interview supervisor to check that procedures are understood and confirm follow up action is taken where deadline is close.
Signature of Asset manager on Form RM001 checked against authorised list by Supervisor.	Enquire of Supervisor as to arrangements for checking proper authorisation when they are absent.

OBJECTIVE	SUBSTANTIVE PROCEDURE
Completeness: All requests for repairs and maintenance (R&M) tasks are recorded.	For a sample of job request forms examine control book to ensure they have been recorded.
Validity: Work is only carried out on properties for which the estates management section is responsible.	Examine records of jobs carried out and confirm that the property is the responsibility of Estates Management.
Accuracy: Time spent on R&M is correctly recorded.	Analytical procedure of amount of time spent on jobs plus non-effective time equates to total man-hours available.
Timeliness: All requests are fulfilled within one calendar month or according to agreed deadline.	For a sample of completed jobs confirm by examination or records that it was completed within deadline.
Authorisation: All requests for R&M must be approved by the responsible asset manager.	Examine sample of forms to ensure they are signed and that signature appears on the authorised list.

1 mark per test given up to a maximum of 10

(c) Forms of internal audit reporting during and after audit:

Form of report	Reason
Formal or informal verbal discussion.	To discuss preliminary findings or resolve minor issues.
Letter to head of unit or director of finance.	To communicate urgent findings for immediate action.
Written audit report.	Containing findings and recommendations.

1 mark per point made up to a maximum of 6

(20)

Question 3

(a) Three key components of an effective risk management process:

- Risk identification or assessment.
- Risk analysis or evaluation.
- Risk management.

1 mark per point made up to a maximum of 3

(b) Outline of steps which risk managers should take at each of the above stages:

- All risk management begins by understanding the objectives of the organisation.

Risk identification or assessment:

- Identify the threats faced by the organisation.
- Identify those areas of the organisation affected by those threats.
- Identify impacts of the threats on delivery of business objectives.

Risk analysis or evaluation:

- Assess likelihood, frequency, significance and consequences of each risk.
- Identify existing controls which might prevent/detect/correct risks.
- Re-assess risks in light of controls (residual risk).
- Profile remaining risks in order of seriousness eg by risk mapping.

Risk management

- Recommend action to be taken to combat residual risk eg which of four strategies to adopt.
- Control the risk – reduce the likelihood of it happening.
- Accept the risk – minor risks could cost more to prevent than to bear the cost when they arise.
- Transfer the risk – eg by insuring against highly unlikely risks over which you have no control.
- Avoid the risk – if it cannot practically be controlled, transferred or accepted but still has large potential impact the organisation may stop doing whatever exposes them to that risk.

1 mark per point made up to a maximum of 12

(c) Role of internal audit in the risk management process:

- Primary responsibility for all aspects of risk management rests with management.
- IA often given task of coordinating or even carrying out risk assessment/management across organisation.
- This may compromise independence if management rely on IA to carry out a management function.
- Role of IA should be to review risk management systems put into place by management to assess adequacy and effectiveness.
- Work of IA may help management in fulfilling their requirements with regard to statements of internal control (SIC).

1 mark per point made up to a maximum of 5

(20)

Question 4

(a) Criteria by which each of the three Es might be assessed:

- Economy – relates to inputs eg cost per unit of input into the agency. Most likely to be related to staff costs.
- Efficiency – relationship of inputs to outputs eg cost of carrying out each departmental/agency review.
- Effectiveness – measure of desired outcomes eg amount of actual or potential savings by departments/agencies in terms of vehicle procurement costs.

Up to 2 marks per point made up to a maximum of 6

(b) Considerations and information sources:

Before commencing fieldwork

Consideration	Source
Operating environment of agency.	General research on current climate in public services.
Policies and objectives.	Agency annual report
Operating practices	Discussion with agency management.
Adequacy of agency management information.	Review of current information available (including limited testing of accuracy etc.).
Selection of evidence gathering techniques.	Audit manuals and methodology.
Key personnel in agency.	Discussion with agency management.
Agency structure and reporting lines.	Organisation chart.

During fieldwork

Consideration	Source
Economy	
Budgeted vs. actual outturn eg on staff costs.	Agency management information systems.
Budget setting processes.	Budget manual; standing financial instructions or similar.
Efficiency	
Comparison to best practice/other similar agencies.	Published performance data and comparative statistics.
Frequency of review of working practices.	Agency internal audit reports.
Effectiveness	
Clarity of agency objectives.	Agency annual report/framework document.
Systems for assessing and reporting performance internally.	Performance indicators.

NB. All considerations and sources are indicative only. Credit will be given for other, appropriate examples.

*½ mark per consideration and ½ mark per source made up to a maximum of 6 each
Total for part (b) – 12 marks*

- (c)** Considerations which would apply after fieldwork was complete:
- Critical review of evidence to conclude whether and how VFM could be improved.
 - Constructive report to management with positive recommendations.
 - Consider possible follow up action at future date.

1 mark per point made up to a maximum of 2

(20)

Question 5

- (a) (i) Main risks which auditors face when auditing in a computerised environment.
- Natural disasters such as power loss, lightning strikes or flood.
 - Breakdowns or “crashes” resulting in major data loss or loss of operational capability.
 - Physical security relating to highly valuable equipment.
 - Problems with physical operating environment eg air conditioning, fire systems.
 - External and internal attack from viruses eg from links to internet.
 - Lack of transparency of control operations in computerised controls.
 - Over-reliance on the computer to operate properly – auditing around the computer.
 - Summarisation of data may remove audit trail.
 - Systems do not preserve real-time data for future audit inspection.

1 mark per point made up to a maximum of 7

- (ii) Difference between *general* and *application* controls.

General controls:

- Relate to the environment in which computer based systems are developed maintained and operated.
- Relate to ALL applications within an organisation.

Application controls:

- Controls which relate solely to a specific computer system or application.
- Concerned with the completeness, accuracy, security and effectiveness of data processing.

*1 mark per point made up to a maximum of 4. 1 marks for presentation
Total for part (a) – 12 marks*

- (b) Suggested computerised controls:

Each supplier is allocated a unique supplier reference code;

Supplier reference code is designated a compulsory entry field. Payment will not be processed without an entry in this field.

The supplier code contains both numeric and alpha-numeric characters in a set format;

Computer will not proceed with a payment if the code entered is not in the correct format.

Payments are approved by budget holders who prepare the necessary input documents; these are then processed by payments clerks in batches of fifty;

Operator manually calculates total of payments and enters this into computer. Computer compares total with that of payments input and will not proceed unless totals agree.

Payments of amounts up to £5,000 may be authorised by the payments clerks. Amounts over that require the approval of the payments section supervisor;

Payments £5,000 or over cannot be processed without the supervisor's authorisation code being entered from their terminal.

*Up to 2 marks for a well explained control;
1 mark for basic explanation up to a maximum of 8*

(20)