

## AUDIT AND ASSURANCE

### Diploma stage examination

**9 June 2006**

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

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

Answer **four** questions in total: **One** question from **Section A** and **three** questions from **Section B**. The marks available for each question are shown in italics in the right-hand margin.

*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 the head of internal audit at a medium sized National Health Service Trust. You have just received the following:

**CONFIDENTIAL MEMORANDUM**

From: J. Carl Black, Chief Executive (CE), Gateshull Acute Hospitals NHS Trust  
To: Head of Internal audit (HIA)  
Date: 09/06/2006  
Subject: Restructuring of Internal Audit (IA) Function

As you are aware the Trust has, since its creation 10 years ago, always provided its IA services "in-house". At the last meeting of the Trust's Board, however, it was agreed in principle (based on proposal by the Chair of the Audit Committee) that we explore the possibility of alternative arrangements.

Our Audit Committee Chair explained that she had been approached at a recent Health sector conference by the Chair of the Audit Committee at our neighbours, Solihead NHS Trust. He suggested that the two trusts create a jointly owned internal audit consortium by merging our IA function with theirs. They too have an in-house IA but it is only about three-fifths the size of ours and they are finding the cost of maintaining it too much. Their HIA is due to retire in six months or so and this seemed like an opportune moment to review the situation.

To add fuel to the fire, as it were, Solihead had already been approached by a third trust who wanted them to provide their IA services when the other Trust's contract with a private sector firm ends in about 15 months' time. It looks like this could be a growth area and the Board feel we should at least explore the possibility.

What I need from you is a paper setting out your thoughts on what this might involve. I must stress that it is still only an agreement in principle – nothing definite has been decided – and for the moment we should keep this strictly confidential.

What I had in mind was a report from you to the Board setting out a few of the key issues. Perhaps you could consider the following:

- (a) The idea will no doubt need to be sold to the Board so I think we need to kick off with some of the main advantages to the parties involved of the new arrangements. Point out some of the problems that might be involved too.
- (b) What might the terms of reference of the new consortium be with regards to their roles and responsibilities to the participating Trusts? I know we have our own at the moment but I would like you to recast them on the basis that the new arrangements go ahead.
- (c) With the possibility of multiple clients under the proposed arrangements the relationship between IA and management (and the external auditors too!) could get confusing. Many of the board are not particularly clear on what the relationship is at present so include something in general terms on the respective roles of all three and how working together will benefit everyone. Didn't the Audit Commission have something called the "Managed Audit" which went into all this? I think that should be your starting point.

- (d) There already seems to be some interest in having the consortium supply IA services in other Trusts. Could this be extended to outside the health sector? Do other public services have to have internal audit? What are the chances of selling our services in these and the private sectors?
- (e) With accountability being the name of the game nowadays, I think it would also be a good idea to illustrate how the performance of the proposed service would be assessed. Every other service seems to have performance indicators nowadays, so could you prepare some for internal audit?

I appreciate that you have a lot on your plate at present but the Board are very keen to get this moving, so if I could have your draft report as soon as possible that would be very much appreciated. No doubt it will need a bit of fine tuning before it goes to the board, but I would like at least to be able to see our way forward on these issues.

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- **Requirement for question 1**

Prepare the report requested by the Chief Executive dealing with the issues he raises. Marks will be awarded according to the following schedule:

- (a) 6 marks.
- (b) 10 marks.
- (c) 8 marks.
- (d) 6 marks.
- (e) 8 marks.

*Marks for presentation and format 2*

**(40)**

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**Section B (Answer three questions from this section)**

2

You have recently taken up a new post as Team Leader in an internal audit department at a local authority. Your boss, the Head of internal Audit, has asked you to make your first priority the completion of a task which relates to the audit of the authority's estates management section. The main task carried out by this section is the repair and maintenance of the authority's buildings, excluding housing stock.

You will be managing the audit on a day-to-day basis. Your boss has also told you that you will be responsible for reporting back to the audited department both during and after the audit. The immediate task had been started by the person you replaced but not finished before you took up post. You have examined the working papers left by your predecessor and find that they had already identified and documented the main control objectives and key controls within the system. It remains for you to draw up a list of tests of control and substantive procedures which your team will carry out.

The following are the objectives and controls previously documented:

<b>OBJECTIVE</b>	<b>CONTROL</b>
Completeness: All requests for repairs and maintenance (R & M) tasks are recorded.	Asset managers submit form RM001 with details of requirements and Estates Management Supervisor logs all requests submitted in job control book.
Validity: Work is only carried out on properties for which the estates management section is responsible.	All authority premises allocated unique reference codes and Estates Management Supervisor checks details from RM001 to approved list.
Accuracy: Time spent by R & M staff is correctly recorded.	All staff required to submit weekly timesheet showing time spent against property reference.
Timeliness: All requests are fulfilled within one calendar month or according to agreed deadline.	Supervisor reviews progress of jobs against deadline on a weekly basis.
Authorisation: All requests for R & M must be approved by the responsible asset manager.	Signature of Asset manager on Form RM001 checked against authorised list by Supervisor.

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- **Requirement for question 2**

- (a) Distinguish between the purposes of tests of control and substantive procedures and explain their relationship. 4
- (b) Give a test of control and a substantive procedure for each of the objectives and controls set out above. 10
- (c) What forms might your reporting take both during and after the audit of the estates management function and why might you use them? 6

**(20)**

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**3**

Auditors and business managers are increasingly being asked to consider how their organisations manage the risks they face. The risk management process has become increasingly formalised over time. There are a number of key stages which risk managers may now be expected to follow as part of an effective risk management strategy.

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• **Requirement for question 3**

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| (a) What are the three key components of an effective risk management process? | 3  |
| (b) Outline the steps which management should take at each of these stages.    | 12 |
| (c) What should the role of internal audit be in the risk management process?  | 5  |

**(20)**

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4

You are the external audit manager responsible for the conduct of a major value-for-money study being carried out on a central government agency. The aim of the study is to examine and report on the economy, efficiency and effectiveness with which the agency has carried out its task of improving vehicle procurement in government departments.

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• **Requirement for question 4**

- (a) Define the "three E's" and suggest a criterion by which **each** of these might be assessed with regard to the work of the agency. 6
- (b) What issues might you consider as part of your review of the agency both before commencing and during your fieldwork? Suggest possible sources for information relevant to the issues you have given. 12
- (c) What further steps would you take after your fieldwork was complete? 2

**(20)**

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5

As part of your ongoing scheme of professional development, your firm has seconded you to the information technology (IT) audit section. Your firm provides external audit services to a range of clients in both the public and private sectors.

The first thing that happens when you join the IT audit section is that you are sent on a training course to give you the grounding in the skills which you will need. As homework for tomorrow you are required to prepare a paper for presentation to the rest of the class. The topics you have been given for preparation are: the risks of auditing in an IT environment; and the different types of controls which might be present in an organisation which relies on IT systems.

The whole class has also been given short notes on a computerised bill payment system and asked to suggest examples of the sorts of system specific controls which might be in place. The key points of the system you have been asked to consider are:

- (i) Each supplier is allocated a unique supplier reference code.
- (ii) The supplier code contains both numeric and alphanumeric characters in a set format.
- (iii) Payments are approved by budget holders who prepare the necessary input documents. These are then processed in batches of fifty by payments clerks.
- (iv) 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.

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• **Requirement for question 5**

- (a) Prepare a paper for distribution to the class tomorrow which sets out:
  - (i) The main audit risks in a computerised environment. 7
  - (ii) The difference between *general* and *application* controls. 4

1 mark for presentation
- (b) Suggest computerised controls which might be present within the system as described above, with regard to the key points identified above. 8

**(20)**