

AUDITING

Professional 1 examination 10 December 1999

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. Each question carries 25 marks. The marks available for each question are shown in italics in the right-hand margin.*

All workings should be shown. Where calculations are required using formulae, calculators may be used but steps in the workings must be shown. Calculations with no evidence of this (for example, using the scientific functions of calculators) will receive no credit. Programmable calculators are not permitted in the examinations room.

Formula sheets, statistical tables, graph paper and cash analysis paper are available from the invigilator, where applicable.

1

You are keen to impress your Chief Internal Auditor and offer to give an in house seminar on the theme of 'Raising the profile of Internal Audit (IA) within a public sector organisation'.

You chose the topic 'Raising the profile of Internal Audit', as you feel that the current profile of Internal Audit within your organisation is not very high.

- **Requirement for question 1**

Prepare a series of discussion papers for the seminar on the following areas in respect of raising the profile of Internal Audit.

Use examples where possible to illustrate your points.

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|-----|---|------|
| (a) | The importance of raising IA profile – including the advantages and disadvantages. | 4 |
| (b) | The approach to be employed to achieve an increased IA profile. | 11 |
| (c) | How to use benchmarks as a guide to delivering added value audit. | 3 |
| (d) | How Control Risk Self Assessment (CRSA) can be useful to improve the internal audit function and act as an aid to management control. | 7 |
| | | (25) |

2

A number of local authorities have recently been in receipt of bad publicity both from the press and the media, due to the publication of public interest reports from the external auditor.

These issues have affected both officers and councillors and have led to resignations from the organisation both on a voluntarily basis and on request.

- **Requirement for question 2**

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| (a) | Explain what is meant by the term ‘report in the public interest’ as outlined in the Local Government Finance Act 1982 and the Audit Commission Act 1998. | 2 |
| (b) | Provide examples of matters which, if significant, might call for a report in the public interest. You may illustrate your answer with specific examples of recent cases of reports in the public interest issued by the external auditor. | 7 |
| (c) | The local authority external auditor has a far wider impact on the organisation as compared to his private sector counterpart partly because of the availability of the report in the public interest, and for this reason is more of a champion of the public. Discuss. | 6 |
| (d) | Apart from any report in the public interest, the auditor must report on the annual financial statements. In forming his opinion on the financial statements he must satisfy himself/herself that certain criteria have been met. This will lead to an unqualified or qualified audit report. Explain the criteria by which he will decide on whether to leave the report unqualified or to qualify the report. | 6 |
| (e) | When the external auditor completes the audit and forms his/her opinion, it is based on a number of findings and conclusions drawn from the tests undertaken by the audit team. It is important that the auditor undertakes a backwards view of the audit - this is often referred to as debriefing. Explain what is meant by debriefing and illustrate the two methods that are used. | 4 |

(25)

3

The Audit Commission's annual study of Local Government fraud published in October 1998 revealed that fraud and corruption detected during 1997 cost councils in excess of £4 million.

Examples of the frauds committed included such issues as ghost employees, ghost pensioners, and payment for goods and services not received. The study highlighted the fact that unrestricted access to computer records can very often aid the individual to undertake the fraud.

The Audit Commission report goes on to say that, whilst detection rates may have improved, prevention and detection factors still need improving as well as encouraging whistleblowing in order to reduce the levels of fraud.

The report found that many councils remain complacent about the impact of corruption. Many did not have registers of officers' interests or the hospitality received by councillors. There were numerous cases where there was no anti fraud strategy, while another area of concern was the lack of arrangements for protecting whistleblowers.

- **Requirement for question 3**

Students may answer the requirements below by referring to an organisation with which they are familiar.

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| (a) | Prepare a short report to your Chief Officer that outlines the respective roles of the internal and external auditors in respect of fraud and corruption prevention and detection. | 7 |
| (b) | What are the merits for an organisation maintaining a register of officers' interests and hospitality received by councillors, members, management and the board? | 4 |
| (c) | As an auditor you have been asked to provide a guideline as to what you would expect to find within an anti fraud strategy document. | 6 |
| (d) | 'If auditors and managers reviewed the existence and effectiveness of sound internal controls on a regular basis, there would be no need for whistleblowers.' Discuss. | 8 |
| | | (25) |

4

The University of Hightowers has recently introduced corporate credit cards for use by the Vice Chancellor and other members of the directorate. The reason for this is that it is easier to keep a check on credit card payments than cash, while it is also a much more convenient way of paying than drawing cash or arranging payments by invoicing. Foreign currency transactions are also far more convenient by credit card when booking international conferences and for incidental expenses incurred abroad that are normally reimbursed on return to the UK.

- **Requirement for question 4**

You are the senior auditor in the internal audit function at the University. Prepare a detailed set of audit notes that can be used for audit reference and filed on the audit file for the following key areas:

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|-----|--|---|
| (a) | What are the main control objectives attached to the issue and use of credit cards to senior personnel? | 5 |
| (b) | What controls would you expect to see in existence in respect of the credit card statements prior to payment to the credit company? | 7 |
| (c) | How can the existence of an Audit Committee help the internal auditor in the event that a member of the directorate is suspected of fraud? | 4 |
| (d) | Analytical review and statistical sampling are both techniques used by the auditor when gathering appropriate audit evidence from which to form an audit opinion. Explain the type of analytical review and audit sampling techniques that you may use when auditing the credit card expenses of the Vice Chancellor and members of the University directorate. Illustrate your answer with examples relating to the audit of credit card expenditure. | 9 |

(25)

5

Mrs Ina Raje is a newly elected local government councillor for Fiddlers Elbow County Borough Council. She sees herself as the champion against petty fraud within the authority.

During her campaign for election a number of the electorate approached her about the ease by which employees had access to all kinds of building materials from the council's stores depot situated on the outskirts of her ward.

During her first week as councillor she approached the Director of Property Maintenance, Mr R U Shokked, confronting him with the allegations of theft and abuse of overtime by employees of the department. His initial reaction was to request a list of named personnel, however Ina did not have these details available, and preferred to pursue the issue of how this could occur.

Mr Shokked would not discuss the issue with Ina apart from saying that the department had recently undergone an internal audit and that no issues were raised by the auditors. He considered this an indication that confirmed his belief that the Property Maintenance Unit provided a quality service and good value for money to the authority.

Undeterred, Ina Raje then approached the Chief Finance Officer, Ms M N Appeal, who asked to see the audit report on the department, specifically the stores depot.

Ina Raje queried the stock control policy and the job costing documents and the reconciliation of the stores issues to the jobs undertaken by the workmen. This enquiry by the Chief Finance Officer caused the audit department to review its current audit approach to the Property Maintenance Unit.

- **Requirement for question 5**

As the senior auditor for the Property Maintenance Unit, write a report to the Chief Finance Officer that covers the following issues.

- (a) Describe and identify separately the audit tests (compliance and substantive tests) that you would undertake in the stores department in relation to receipt, storage and issue of stock. 10
- (b) Explain the merits of reconciling the job request/ tasks against the actual utilisation of resources and materials used in completing the job. 6

- (c) Why is the concept of value for money important in the public sector? 3
 - (d) What different approaches and methodology might an auditor employ to undertake a value for money audit of the Property Maintenance department stores. 6
- (25)