

# AUDITING

**Professional 1  
December 1999**

## MARKING SCHEME



### Question 1

(a) ***The importance of raising IA profile – the advantages and disadvantages.***

First the organisation must decide whether the profile needs raising. Once this has been agreed then a plan of action that is agreed with the relevant parties must be drawn up.

*Plus points- advantages*

- Key issues can be identified and highlighted.
- Management can provide moral, financial and supporting assistance.
- There is pure commercial viability sense in following a ‘selling/ marketing programme’ on the IA.
- The organisation will benefit by seeing the added value provided by the audit department.
- Audit will be used more appropriately by management.
- Easier to attract staff to a high profile part of the organisation.

*Minus points- disadvantages*

- If audit claim to provide a good value service then it can cause a reaction from clients when they don’t get what the advertising campaign claims the audit can do.
- There is a higher risk of failure among the audit section if staff cannot meet the standard expected, greater pressure on current staffing levels may lead to audit merely doing the attainable and not the expected.
- When the profile of audit is increased and they set out what they can and will do it opens the gates for competitors who can claim to do the same for less fees.
- Some older traditional auditors within the group may consider this to be merely a gimmick and think that the status quo is best, thereby creating a negative atmosphere for the acceptance of the new look audit.

*½ mark per point to a max of 4*

(b) ***The approach to employ to achieve an increased IA profile***

- Identify the current good points within the section, undertake a SWOT analysis of the existing situation as seen from within the section/ department.
- Find out what the current view of audit is within the organisation and list the main points raised by others.
- Establish what the morale of the section is, the staff structure and attitudes.
- Undertake a quality review of activities, identify consistent good practice and highlight the weaknesses.
- Consider the approach to follow to improve current problems that have an impact on quality.

- Identify the costs of the section, control them or reduce them, prepare cost ratios and utilisation rates.
- Start on ‘selling’ the audit programme of events, hold information seminars, pre audit meetings with clients to set out the objectives.
- Be prepared to give advice rather than criticism.
- Use performance measures on audit activities and audit output.
- Undertake staff appraisal to identify personal goals and resources required to meet these.
- Commence issuing post audit review questionnaires.
- Consider feedback from Audit Committees where they exist.
- Improve the audit plan, encourage staff input and ensure staff are communicated the plan.
- Undertake a different approach to the audit; do more risk based and managed audit activities.
- Acquire an Investors in People certificate and follow ISO 9001 – quality of service provision.
- Follow the Quality Improvement Scheme recommended by CIPFA on peer assessment.
- Ensure a professional marketing approach where the IA profile is sold to the client in terms of a professional quality service that gives assurances and advice to the client.
- Prepare articles for the in-house journal, design brochures, take note of feedback and even have an office reception desk.
- Make presentations to key groups within the organisation.
- Contact number/name for whistle blowing
- Email address/Web page

*1 mark per point to a max of 11*

(c) ***How to use benchmarks as a guide to delivering added value audit.***

What are benchmarks? Sets of marks by which a level of service can be assessed against.

- Which benchmarks are applicable? IA will need to be gauged against others in the same field, those from outside the public sector and other models possibly from other countries.
- Benchmarking against:- Achievable models.
- Benchmark against sector norms and surveys.
- Benchmark against specific groups.
- Benchmarking can provide guidance to the quality of audit output, prove that IA is worthwhile and improve the service provision of IA.
- By using a benchmark it can give an indication as to whether customer expectations of the service have been met.

- The technical quality of the audit provision can be assessed to see whether all issues have been addressed and whether the findings have been effectively communicated.
- The skills base of an IA section can be measured and assessed according to skills levels, expertise and the right mix of skills, knowledge and experience.

*½ mark per point to a max of 3*

(d) ***The usefulness of CRSA as an audit tool***

- CRSA is based on an organisation's ability to undertake an assessment of its own risks whereby the managers of sections/ departments/ cost centres actually take on board the assessment of the controls that exist within their own organisation.
- This will entail reviewing the existing controls for effectiveness and the implementation of improvements.
- CRSA can mean that it enhances the existing process whereby auditors are currently educating managers of the importance of internal controls. It can add value, cut time and give a better focus on the internal control audit procedure.
- CRSA means educating those involved via means of workshops where the potential risks are introduced to the managers within their areas of control and they then consider the effectiveness of these controls by means of answering key control questions. From this study the auditors can highlight possible risk areas and draw them to the attention of the managers.
- Educating those involved can be resource hungry, however the benefits gained can often outweigh the costs.
- Client must show commitment to the process and take on board the recommendations and findings. By allowing CRSA then it means fewer people are involved in auditing the same processes. It can direct audit testing to the critical areas thereby releasing resources to undertake more effective audit work.
- The impact on the audit means that it may alter the audit planning process, and identify the resource availability. Greater allocation of planning time may be necessary while there will be a need to be flexible as an audit team to ensure problem areas are supported and acted upon.
- If audit is to implement and organise the CRSA programme then it must be able to identify the key control areas upon which to set questions to the managers.
- There will be a need to identify risk in terms of the organisation's objectives.
- Evaluate risks against the likelihood of the risk occurring and its potential impact.
- Monitoring the CRSA process will be essential to ensure that it is actively used rather than merely paid lip service.
- Positive image for internal auditor , acting as a facilitator for management in reviewing their own controls.
- CRSA is a supplement to not a replacement of audit.

*1 mark per point to a max of 7*

(25)

**Question 2**

(a) ***'report in the public interest'***

- Local Government Finance Act 1982 requires that the auditor shall consider whether in the public interest a report should be made on any matter which comes to the auditor's attention in the course of the audit.
- The report may be made immediately on discovery or within fourteen days of the conclusion of the audit.
- The Act increased the publicity given to these reports by requiring them to be considered at a full meeting of the council.
- The meeting must be advertised in the local press with a note that the report is to be discussed.

*½ mark per point to a maximum of 2, plus bonus mark if good explanation given*

(b) ***examples of matters which might call for a report in the public interest.***

- The fact that the auditor's opinion on the statement of accounts was qualified.
- The preparation of the accounts for the year end were delayed.
- There was failure to comply with statutory requirements.
- That there exists excessive or inadequate levels of balances, inappropriate levels of provisions, lack of prudence, or prospective budget deficits.
- Lack of action on matters previously reported including value for money issues and opportunities.
- Absence of or weakness in arrangements for securing the three E's.
- Unnecessary expenditure or loss of income due to waste, extravagance, inefficient financial administration, poor value for money, mistakes etc.
- Weaknesses in management information systems and monitoring of expenditure arrangements.
- Objections received during the audit of the authority.
- Frauds, misconduct or special investigations.
- Specific examples of reports in the public sector.

*1 mark per point to a max of 6,  
illustrative examples will earn the students 1 extra mark  
(7)*

(c) ***private sector reports in the public interest***

- Private sector auditors have the right to issue qualified reports, but they are relatively rare.
- If auditors feel that a qualification is necessary they will discuss the issue with the directors and get the financial statements amended.
- Because of the serious nature of the qualified report, auditors are reluctant to give the company the kiss of death.
- The impact of qualification on the share price can be disastrous
- Going concern can become an issue.
- Public sector organisations will still continue to exist despite the report in the public interest, similar reports for a company would mean instant disaster.
- Public sector organisations exist to serve the public and therefore the public should be informed of the issues.
- Companies exist to generate profit, those with vested interests undertake a gamble that it will continue as a going concern.
- However there are other stakeholders too, should their interests all be weighed in the balance.
- The importance of the public interest report in the public sector could be of benefit to the private sector, especially when cases such as Maxwell, Polly Peck, and BCCI come to mind.
- Other relevant arguments will be given appropriate credit.

*1 mark per point to a max of 6*

(d) ***the criteria on whether to leave the report unqualified or qualified.***

When the auditor expresses his opinion on the whether the financial statements of accounts presents fairly the financial position of the authority, the auditor must be sure of the following matters:

- The description of the data / figures is neither ambiguous nor misleading.
- That the statements are free from any material understatements or overstatements.
- That the financial statements comply with all statutory and other requirements applicable to the accounts of the authority.
- That there is adequate disclosure of all appropriate material items.
- That the guidance notes of CIPFA on the application of Accounting Standards to local authorities have been adhered to.
- Consideration has been given to material accounting policies not subject to guidance from Accounting Standards.
- Suitable presentation and classification of all information exists.

- An unqualified audit opinion can include an ‘emphasis of matter’. Drawing to the attention of the reader any matter which requires their attention, but is such that it does not warrant qualification of the financial statements.
- If qualification of the accounts is considered, two areas of relevance are: - capital accounting and creative accounting. Full disclosure in a footnote on the way capital expenditure has been recorded, and that capital accounting treatment is acceptable and consistent. Creative accounting requires full disclosure re transfers to and from special funds to distinguish between actual income and expenditure.
- Management are unwilling or unable to adjust draft accounts to comply with any of the above.

*1 mark per point to a max of 6*

(e) ***debriefing the audit - formal process of documenting and the less formal meeting***

A formal documentation of the auditors thought process bringing the audit to a conclusion, often referred to as a completion memorandum.

Matters to be covered will include;

- How the audit addressed the critical audit objectives set out in the planning document.
- If there were any unusual accounting or reporting issues- stating how they were resolved.
- Any changes to the original planning document.
- Staffing and training issues that may have arisen.
- The confirmation that the planned audit tests were completed and working papers reviewed.
- Auditor’s opinion as to whether the financial statements are free of material misstatements.
- Addressing any matters relating to post balance sheet events.
- Matters for the management letter.
- The less formal approach involves all staff in a meeting after the audit has been completed. Minutes of the meeting are normally kept and it covers the following:
  - Informing the group about the areas of the audit that went smoothly and those that caused difficulty.
  - Lessons can be learnt for the following years audit.
  - Matters to do with the time-tabling can be addressed in the debriefing meeting.
  - Identification of more detailed audit work in certain areas can be done in readiness for the next audit.
  - Minutes of the meeting will form a starting point for the next year’s audit.

*½ mark per point to a max of 4*

(25)

### Question 3

(a) ***respective roles of the internal and external auditors in respect of fraud and corruption prevention and detection?***

- It is the responsibility of management to ensure that the accounting and control procedures operating in an organisation are such that they prevent fraud and corruption or if perpetrated the fraud or corruption will be detected within a short period of time.
- Fraud and corruption usually occurs when the accounting and control systems are abused or are themselves deficient. As internal auditors are answerable to management it could be implied that they have a responsibility for the prevention and detection of fraud and corruption.
- APB Guideline ‘Guidance for Internal Auditors’ statement - confirms this management responsibility for fraud prevention and detection.
- Guideline specifies the responsibilities of internal auditors as:
- ‘Internal audit should have regard to the possibility of malpractice and should seek to identify serious defects in internal control which might permit the occurrence of such an event.’
- An auditor who discovers evidence of, or suspects, malpractice should report it to the appropriate level of management. It is management’s responsibility to determine what further action to take.
- Internal audit must identify control objectives, test these controls and ensure they are adequate and operational.
- Internal audit cannot guarantee to an assurance that fraud does not exist, however tests should be designed in such a way that they can identify any material irregularities.
- Prevention is better than cure
- The external auditor is guided by the APB guideline in relation to fraud, other irregularities and errors and SAS 110.
- The external auditor has the responsibility to plan and evaluate their audit work so as to have reasonable expectation of detecting material misstatements in the financial statements, whether they are caused by fraud or error.
- Local authority and NHS auditors must carry out their duties according to the Code of Audit Practice as approved by Parliament. The auditors duties here include a section on fraud and corruption. Whilst management have overall responsibility the auditor must ascertain whether the authority has taken adequate steps to establish sound internal controls.

*If reference to sector specific then add 1 mark*

- Where fraud is suspected the auditor will work in conjunction with the organisation and if necessary with the police.
- Use of a designated fraud unit.
- Hotline for whistle blowing.

*½ mark per point to a max of 6  
1 mark for correct report format/layout  
(7)*

(b) ***Merits for an organisation maintaining a register of officer's interests and hospitality received by councillors, management and the board?***

- Identifies areas of possible conflict of interest.
- Councillors are required to declare any outside interest that might conflict with decisions made within the authority.
- It clarifies to officers that the organisation is keen to ensure accountability in relation to the use of public funds and that possible corrupt practices are frowned upon.
- A declaration by officers and staff of any gifts from current or potential suppliers / contractors enables the organisation to view whether it is deemed a bribe.
- If a list of 'interests' exists for members and officers known to have specific interests they can be excluded from any decisions in respect of allocation of contracts, opening of tenders etc.
- The concept of openness, integrity and accountability is reinforced through the existence of known interests lists.
- It can avoid any embarrassing or compromising situations for those involved.
- Reference to the Nolan Committee recommendations about the conduct of officers and members.

*1 mark per point to a max of 4*

(c) ***anti fraud strategy document for an organisation expected contents.***

Anti fraud and corruption document

Contents of document should cover the following points in respect of fraud and corruption:

- A document of this kind should be clearly set out what is and what is not acceptable behaviour as far as fraud and corruption is concerned.
- A Corporate Policy document on Fraud and Corruption that has been endorsed by top management and one that is applicable to all employees irrespective of level or length of service.
- All employees are to be made aware of the policy document and expected to comply with the laws and regulations relating to the organisation.

- The document should include guidelines in respect of holding positions such as directorships outside the organisation that could impinge on the activities of the organisations. The guidelines need to cover issues such as conflict of interest, and the importance of declaration of these interests when they apply.
- Employees need to be advised on the importance of complying with policies relating to security and confidentiality.
- Clear policies on use of the organisations assets, i.e. not for personal use.
- Policies relating to the payment of inducements, gifts and entertainment and the acceptance of such gifts and entertainment should be clearly communicated to all levels of employees.
- It is expected that all employees will act with integrity at all times and that they should not engage in any act that is fraudulent even if it may benefit the organisation.
- Cost effective controls and procedures are installed to prevent, deter, detect and to deal with any fraud and corruption that may occur.
- Any suspicious activity is to be reported – i.e. whistle-blowing is encouraged.(PIDA 1998).
- Facility for whistleblowing, names of personnel who may be approached.
- Where employees feel that they cannot report any suspicious activities to their immediate line manager then a line of reporting structure should be outlined.
- The allocation of responsibility for the investigation where any fraudulent activity is suspected.
- Reporting protocol following the investigation.
- An understanding that when a fraud or corrupt activity is under investigation then all employees are expected to assist those undertaking the enquiries.
- A policy outlining any suspension, dismissal and reporting to the police with the view to prosecution.
- A commitment to seek financial recovery through civil proceedings.
- All staff are to be informed of the anti fraud and corruption policy as part of their induction programme and that a copy of the document is included within the Staff Handbook.
- Possible requirement to sign document saying they understand the anti fraud policy document.

*1/2 mark per point up to a max of 6*

- (d) ***the existence and effectiveness of sound internal controls, means there is no need for whistleblowing***

Points that may be raised:

- Sound internal controls are no guarantee that a fraud will not occur, consider the issues that lead to fraud taking place.
- Perception of control is as important as actual impact, Detection / Prevention distinction.
- Sound controls do help to prevent fraud.
- Greatest factor in committing fraud is the opportunity to do it, controls reduce this opportunity.
- Challenge of breaking the system.
- Motivation to get one over on management.
- Thrill of success in getting away with it.
- Theft considered a perk.
- Adverse relationship between staff and management.
- The fraud considered as a debt owing from the organisation to the employee.
- Corruption based on threat or blackmail.
- Collusion between staff breaking conventional internal control.
  
- Effective internal controls may seem on the face to be operating well.
- Audit risk of the auditor not detecting the error or fraud.
- Well known audit tests by the employee can create the smoke screen to the fraud.
- Amount may not be material to warrant concern, however when let to continue the amount may become significant, by which time it may be too late.
- Breakdown of controls occurs over time.

*½ mark per point to a max of 8*

(25)

**Question 4**

'Working papers' that can be filed on audit files to include the following:

(a) ***control objectives attached to the issue of credit cards***

- Expenditure is to be made on items relating to the organisation.
- Expenditure is in accordance with the rules of the organisation.
- Only authorised personnel may be issued with a corporate credit card.
- All items of expenditure must be in conjunction with official business.
- Where applicable the level of expenditure needs to be authorised prior to the payment being made.
- All expenditure is to be appropriately coded to the correct cost centre.
- Expenditure should be within allocated budget figures.
- Balances are paid before interest is incurred.

*1 mark per point to a max of 5*

*For control objectives, give only ½ mark if the objectives are subject interpretation of the control*

(b) ***controls in respect of the credit card statements prior to payment***

- All items purchased by credit card should have supporting receipt and credit card confirmation slip.
- The total purchases are to be checked against the credit card statement.
- Authorised signatures on credit card slips to be checked and confirmed.
- Items listed confirmed as relating to the organisation.
- Appropriate receipts checked against the statement from the credit company.
- The item of expenditure must be checked for correct time period.
- The expenditure to be confirmed against appropriate duties and task undertaken, conferences attended, course, overseas promotional trips etc.
- Prior authorisation of expenditure to be confirm where applicable (may not be so easy where the Vice Chancellor is concerned).
- Signature of staff receiving them on form accepting conditions of their use.

*1 mark per point to a max of 7*

(c) ***role of the audit committee when fraud is suspected of a member of the directorate***

- The Audit Committee has numerous roles, one of which is to ensure co-ordination between the internal and external auditor and also to ensure that the internal audit function is adequately resources with appropriate standing within the organisation.

- As an Audit Committee is concerned with uncovering facts, difficulties and problems, they can be termed as having open government, to this end they can therefore approach the member of the directorate without any threat of dismissal, which may not be the case for the internal auditor.
- In this instance it could liaise with the external auditor and ensure that the investigation is undertaken by the external auditor.
- Act as a go between for internal audit and the member of the directorate, although the whisper of a fraud allegation is unlikely to be well received, whether true or otherwise
- By having an Audit Committee it can strengthen the independence of the audit function. In this case the fact that the audit function probably reports back to the member of the directorate then the Audit Committee avoids the conflict and embarrassment that may arise.
- Help with obstructions put in way of IA's investigation by using its reporting line to the governing body if necessary.

*1 mark per point to a max of 4*

- (d) ***analytical review and statistical sampling techniques used when auditing the credit card expenses***

#### Analytical review techniques

- This is a study of relationships between elements of financial information expected to conform to a predictable pattern based on experience. It involves the breaking down of data into sub divisions.
- The credit card review test would include comparison between budget figures and actual figures, for the current and prior periods on a monthly and annual basis.
- Individual director's expenditure could be analysed according to the types of visits / meetings / conferences/ attended.
- Investigating the variations can in itself be an analytical review process.
- The relative amounts under specific headings on the credit card expenditure can be used to identify a pattern from a previous periods as a form of evidence of the reasonableness of the item of expenditure.

#### Sampling techniques

There are two types of sampling: judgmental and statistical

SAS 100 requires the auditor to carry out procedures that will give sufficient and appropriate audit evidence to meet the objectives of the audit.

- Sampling means that the audit conclusions are based on a representative sample of items, number of claims as opposed to the value of the credit card expenditure.

- MUS to pick the large items of expenditure or Attribute sampling to identify all expenditure on specific flights, accommodations, period , or alcohol.
- If this instance of judgmental sampling is used then the auditor would select items of expenditure based on gut feeling, past events, and any suspicions that may be circulating. (Some staff members may be submitting claims without supporting documentation on a regular basis).
  - Statistical sampling will involve selection characteristics relating to random, haphazard, stratified, cluster, random, value weighted.
  - Statistical software packages are very often used today by a number of auditors, this speeds up the process and provides immediate answers that can be further analysed using IDEA or downloaded data onto MS Office Excel
  - Where sampling techniques are employed it must be remembered that the sample is representative of the whole, otherwise the answer will not reflect what is happening, every member of staff must have the same opportunity to be selected, not merely the same individual all the time.
  - Sampling can be used both for compliance testing and substantive testing, testing the system for authorisation and checking of receipts to that recorded, and the reconciliation of claims against authorised events/ conferences attended, data matching or relational database analysis.

*I mark per point to a max of 9*

*Where a mark can be awarded it may need to be in light of ½ mark for the technique*

*½ mark for appreciation to the question*

(25)

### Question 5

- (a) *summary of tests on the system that should exist in the stores for the receipt, storage, and issue of stock.*

*Compliance test - relate to the system - Substantive tests relate to the transactions*

- Tests the procedures for the receipt of stock, including confirmation of quantities to the order.
- Test existence of clear delivery points and instructions to staff in respect of deliveries at other points.
- Tests as to whether there is a check on goods received and whether it is undertaken by appropriate personnel - qualified to assess whether goods are the right ones, and right quality.
- Check if entry of stock onto goods received note is made prior to entry onto stock record.
- Confirm that the GRN has pre-numbered pages.
- Test that an officer confirms that goods are of appropriate quality and signs an appropriate document.
- Confirm that GRN's are forwarded to accounts department in order that they know goods have arrived prior to payment of invoice.
- Check that any unfulfilled orders are investigated periodically and that any outstanding issues are dealt with and documented.
- Confirm appropriate coding assigned to stock received, undertake a sample test.
- Check that stock records are updated upon receipt of goods, sample stock entries against delivery note dates.
- Undertake a samples stock count to confirm the existence of stock held, or attend a stock taking.
- Identify any obsolete, damaged stock and write off and confirm existence of documentation.
- Confirm appropriate authority exists for any write off and the appropriate signatory is to be found on the documentation.
- Check the all write off is properly documented and entered on the ledger.
- Test check that the storage is in systematic order, according to right, size, accessibility, care given to heat sensitive stock and life span in terms of 'use by date' e.g. plaster, obtain advice of 'expert' if necessary.
- Check that adequate security exists to ensure that stock is not open to theft, lock and key system and key holders, security alarm and holder of 'security code' .
- Test to ensure that issues only made when appropriate authorised documents supplied.
- Confirm by sampling a number of issue document that they have written word as well as a numerical section to avoid tampering/ alterations to quantities after initial approval.

- Check that stock records are updated to take into account the issues made, use a recent issue document as a sample or use selected period.
- Observe that staff sign for stock issues as confirmation of receipt, check for staff signatures on past records.
- Confirm that all issues appropriately documented and reconciled with job order by management on a periodic basis.
- Confirm that segregation of duties exists in terms of receipt storage and issue.
- Confirm that appropriate authorised personnel investigate differences in actual stock and stock records.

*1 mark per point to a max of 10*

(b) ***merits of reconciling the job request/ tasks against the actual utilisation of resources***

- Ensures appropriate materials/ stock used for the job.
- Enables correct recharging process to be employed.
- Provides confirmation that estimates and actual can be confirmed.
- Ensures only the right amount of stock is used per job.
- Allocates responsibility onto work-force to ensure that only required stock is used - they may have to provide explanations for discrepancies.
- Allows value for money reviews to be undertaken both by management and for audit purposes.
- Cost comparison is aided especially when cost exceed estimates due to poor purchasing policies or increased prices.
- Cost price of stock purchases can be reviewed and alternative goods purchased where applicable.
- Shows up level of shrinkage / damage/ obsolescence write off control.

*1 mark per point to a max of 6*

(c) ***importance of value for money in the public sector?***

- Scarce resources and ever increasing demands on the public purse means that value for money is an essential component of public sector expenditure.
- Expenditure out of the public purse has always been viewed as requiring more safeguards than expenditure out of the private purse of a company.
- Recent issues relating to cases of extravagance have increased public awareness and the need to display VFM has become more important - students can give examples here.
- Definition of VFM - re the three E's - economy, efficiency, and effectiveness.
- The external auditor has a responsibility to ensure that value for money is excised by the organisation.
- No profit measure in the public sector.

*I mark per point to a max of 3*

(d) ***aspects to audit when undertaking a value for money audit of stores.***

- Value for money audit on a stores – approach.
- Main source of professional guidance - APC Audit Brief 1990 - ‘Value for Money Audit’.
- Audit will normally involve three stages -
  - review input and outputs;
  - review of organisation and procedures;
  - review of effectiveness;
- application to the scenario -
  - policy objectives / performance targets;
  - management control
  - ensuring staff have relevant skills;
  - examining way that function is performed;
  - ensuring procedures are carried out to a recognised standard in line with best practice.
- Structured technique for VFM auditing;
  - input based review;
  - systems based review;
  - output based review;
- Examples relating to the scenario in terms of:
  - identifying objectives/using comparisons/cost analysis/purchasing policies
  - security aspects /issue of stock and documentation.

*max marks awarded 6*

*I mark to be awarded where the report format has been used*

*(25)*