CIPFA

AUDIT AND ASSURANCE/FINANCIAL REPORTING

AAT Fast-track examination

11 December 2006

MARKING SCHEME

AT THE HEART OF
YOUR CAREER

Question 1

(a) Explain briefly which organisations provide external audit for each of the following parts of the public sector and explain who controls their appointment as external auditors

(i) Local Authorities and the NHS in England

The external auditors of local authorities and the NHS within England and Wales are either private firms or the District Audit Service (the operational arm of the Audit Commission)
The appointments are all controlled by the Audit Commission.

(ii) Universities in the United Kingdom

Universities are audited by firms of accountants, who are eligible for appointment as company auditors.
The Universities control the appointment of their external auditors themselves.

(iii) Central Government Departments

Control of the appointment of auditors to central government departments is exercised by Parliament. The Government Resource and Accounts Act 2000 appoints the Comptroller and Auditor General (head of the National Audit Office) as the auditor of all government departments.

Central Government Departments are audited by the Comptroller and Auditor General of the National Audit Office.
Appointments are made to the audits by the National Audit Office itself, which sometimes subcontracts the work to private firms.

For each section, 1 mark for identifying the auditor, 1 mark for identifying who controls the appointment process and 1 mark for any other relevant comment up to a maximum of (6)

(b) Explain in outline the key human resources issues for an organisation establishing an internal audit unit.

Proper Mix
There must be a proper mix of staff in terms of experience, competence and seniority.

Flexibility
There must be sufficient staff time available to deal with unforeseen emergencies and special assignments.

Staff must individually also be flexible about the type of assignments they are willing and able to carry out.

Personal qualities
Audit staff need to have the relevant personal qualities to make them suitable for the work.

They need to be numerate, articulate, and able to deal with staff at all levels of the organisation.

Training
All audit staff should receive appropriate training to assist them in improving their performance at their work.

Training should be suited to the position staff are at in their career. It should also emerge from an appraisal system, which aims to measure auditors' effectiveness for their jobs.

1 mark for each of the above and any other relevant points up to a maximum of (6)

(c) Briefly detail what controls you would expect to see when contracts are tendered by a public service body.

Tendering procedures should be part of standing orders, which should specify certain specific controls.

The overall objective of these controls is to ensure not only that controls are fair but that they are seen to be fair.

Tenders should be required to be returned in a standard format and enclosed in a plain envelope (so that no one can identify who the tenderer is).

There should be a formal submission time and date.

When tenders are received they should be stamped with the date and time of receipt; details of each tenderer should be entered into a register.

During the period between receipt and opening of tenders they should be stored securely.

There should be at least two people involved in the tender opening procedure and neither should be involved in the contract letting procedure.

Immediately on opening, tenders should be briefly reviewed to ensure they cover the required specification and that the costs have been correctly added up.

Tenders should then be fully evaluated by a team of people including those responsible for letting the contract.

Retendering will only be offered in exceptional circumstances and then must be offered to everyone.

There might be a renegotiation of two or more tenders if they are all very close in price. All such renegotiations should be recorded in writing.

Award of the contract should take place by a properly authorised group and there should be a clear line of reasoning for choosing the preferred tender.

Within the European Union over a certain spending limit special rules apply to tendering by public service bodies, which require the whole process to be started by an advertisement in the Official Journal of the European Union.

1 mark for any of the above or any other relevant point up to a maximum of (9)

(d) Identify and briefly describe the six approaches to Control (Risk) Self Assessment (CRSA), which internal audit or management might employ. Explain the factors which influence the success of a CRSA process.

The six approaches to Control Risk Self Assessment are as follows:

- It is possible to build upon the existing audit systems by encouraging greater participation by the auditees in the process of identifying controls
- Audit can initiate control awareness seminars
- Management can use control questionnaires as a framework to evaluate risks and controls
- Managers can self-certify the quality of the controls for which they are responsible
- Management can lead an evaluation of risks and controls through workshops and focus meetings
- Management and staff can assume total responsibility for control design, implementation and review

In essence control risk assessment can be driven by audit or by management or jointly. The key differences in the approaches are who (management or audit) takes the initiative and what medium is used to introduce the process.

The main reasons for the success or otherwise of a CRSA process are:

- The degree to which staff at all levels, who operate controls, are involved in the process
- The degree to which staff "buy in" to the process as something relevant to them.
- The extent to which senior management champion the process
- The effective communication to those involved of the objectives and methodology of the process.

1 mark for each approach identified to a maximum of 6 and 1 mark for each determinant of success up to a maximum of 5. Marks to be allocated as appropriate for a general description of the different types of CRSA methodology, which does not identify specific options. Overall maximum of (9)

(30)

Question 2

(a)

Tangible fixed assets	Land	Buildings	Equipment	Investment property	Total	
Cost or valuation	£m	£m	£m	£m	£m	
As at 1 November 2005	1	32	44	18	95	*2*
Additions	3	8	9		20	*1 ½*
Disposals			(15)		(15)	*½*
Revaluation adjustment				4	4	*½*
As at 31 October 2006	4	40	38	22	104	*½*
Accumulated depreciation						
As at 1 November 2005		13	18		31	*½*
Charge for the year		4	8		12	*½*
Withdrawn on disposals			(12)		(12)	*½*
As at 31 October 2006		17	14		31	*½*
Net book value						
As at 1 November 2005	1	19	26	18	64	*½*
As at 31 October 2006	4	23	24	22	73	*½*
						(8)

(b)

Karactus plc
Profit and loss account for the year ended 31 October 2006 *1*

	£m	*½*	
Turnover	266	*1*	
Cost of sales	(185)	*4 ½*	*w*
Gross profit	81	*½*	
Distribution costs	(17)	*1 ½*	*w*
Administrative expenses	(22)	*2*	*w*
Other operating income	11	*½*	
Operating profit	53	*½*	
Income from fixed asset investments	8	*½*	
Interest payable	(2)	*½*	
Profit on ordinary activities before taxation	59	*½*	
Tax on profit on ordinary activities	(22)	*2 ½*	*w*
Profit for the financial year	37	*½*	
Earnings per ordinary share (in pence)	46.3	*2*	*w*

Note: Earnings per share
Earnings per share is based upon the earnings attributable to ordinary shareholders of £37,000,000 divided by the 80,000,000 ordinary shares issued and ranking for dividends.

1 ½

(20)

Workings

Gain on fixed assets disposals

	£m
Proceeds from sale	7
Book value of equipment sold	3
	4

Allocation of expenses	Cost of sales	Administrative expenses	Distribution costs	
	£m	£m	£m	
Per trial balance		17	14	*½*
Opening stock	21			*½*
Error in opening stock	(3)			*1*
Purchases	188			*½*
	206			
Closing stock	(23)			*½*
	183			
Surplus on disposal of assets	(4)			*1*
Depreciation for the year				
Buildings	2	1	1	*1 ½*
Equipment, at cost	4	2	2	*1 ½*
Increase in allowance for bad debts		2		*1*
	185	22	17	
	4 ½	*2*	*1 ½*	*(8)*

Corporation tax		
Provision for the current year	11	*½*
Previous underprovision	6	*1*
Transfer to deferred taxation	5	*1*
Charge for the year	22	*(2 ½)*

Calculation of earnings per share	£m
Earnings attributable to ordinary shareholders	37
Balance on ordinary share capital	40
Face value per share (£)	0.5
So, number of shares issued (millions)	80
Earnings per ordinary share (in pence)	46.3

(c)

Movements in share capital and reserves	Share Capital £m	Share Premium £m	Revaluation Reserve £m	Profit and Loss Account £m	
Balance as at 1 November 2005	32	14	10	35	*2*
Bonus issue of shares	8	(8)			*1*
Error in opening stock				(3)	*1*
Surplus on revaluation of investment property			4		*1*
Profit for the financial year				37	*1*
Dividends paid				(10)	*1*
Balance as at 31 October 2006	40	6	14	59	
					(7)
					(35)

Question 3

(a)

	£000
Contract value	980
Costs to date	(750)
Estimated future costs	(350)
Estimated profit/(loss)	(120)

Profit and loss account figures:	£000		
Turnover	480	*	*2*
Cost of Sales (balance)	640	***	*2*
Profit	(160)	**	*2*

* Work certified to date (580) less turnover recognised in the previous year (100)

** Cumulative loss to date (loss of 120) adding back profit recognised in previous year (40)

*** balancing figure

Balance sheet figures:

Work in progress:	£000	
Costs to date	750	*1*
Transferred to Cost of Sales	640	*1*
	110	
Amounts recoverable on contracts:		
Turnover	580	*1*
Value of work invoiced	420	*1*
	160	
Trade debtors:		
Value of work invoiced	420	*1*
Payments received	400	*1*
	20	
		(12)

(b)

	£	
Cash received from customers	16,749,200	*4*
Cash payments to suppliers	(13,344,530)	*3*
Cash paid to and on behalf of employees	(941,700)	*3*
Other cash payments	(676,400)	*4*
	1,786,570	
		(14)

Workings

Cash received from customers	*w*	£
Opening trade debtors	*1*	240,600
Sales	*1*	16,750,000
Discounts allowed	*1*	(20,400)
Closing debtors	*1*	(221,000)
Cash received from customers		16,749,200

Cash payments to suppliers		£
Opening trade creditors	*1*	186,530
Purchases	*1*	13,404,000
Closing creditors	*1*	(246,000)
		13,344,530

Cash paid to and on behalf of employees		£
Wages and salaries	*1*	955,000
Accrued at start of year	*1*	21,300
Accrued at end of year	*1*	(34,600)
		941,700

Other cash payments		£
Operating expenses exclude	*½*	2,160,768
Depreciation	*½*	(484,668)
Wages and salaries	*1*	(955,000)
Discounts allowed	*1*	(20,400)
		700,700
Prepaid at start of year	*½*	(32,800)
Prepaid at end of year	*½*	8,500
		676,400

(c) (i) Gross profit %

- Increase selling prices more than any increases in purchase prices
- Seek to reduce manufacturing costs or the cost of purchases
- Pass increases in manufacturing costs or the cost of purchases on to customers
- Reduce stock losses e.g. due to theft, pilferage or deterioration
- Change the sales mix by increasing the proportion of sales attributable to higher margin products

(ii) Net profit %

- Increase the gross profit % as above
- Reduce selling and distribution expenses relative to sales
- Seek to increase non-operating income

(iii) Stock turnover rate

- Reduce the level of stock held relative to activity
- Increase the level of activity while maintaining or reducing the level of stock held

1 ½ marks per valid point to a maximum of (9)

(35)

Question 4

(a) Segmental Report.

	Total	Hi-Fi Division	Musical instruments	Furniture	
					1
	£m	£m	£m	£m	*½*
Turnover					
Total sales	1,132	687	235	210	*4*
Inter-segment sales	77		28	49	*4*
Sales to third parties	1,055	687	207	161	*1*
Profit before taxation					
Segment profit/(loss)	161	155	22	(16)	*4*
Common costs	89				*1*
Operating profit	72				*1*
Net interest	13				*1*
Group profit before tax	59				*1*
Net assets					
Segment net assets	396	261	61	74	*4*
Unallocated assets	70				*1*
Total net assets	466				*1*

Turnover	Total	UK	Africa	Asia	
	£m	£m	£m	£m	*½*
Turnover by destination	1,055	214	473	368	*4*

(29)

(b) The depreciation schedule for this asset will be revised as from the current year to reflect the revised expectations for the machine. Its current carrying value is £9,600. The new depreciable amount is £8,100 [£9,600 less £1,500]. This will be written off equally over the years ending on 31 October 2006 and 31 October 2007. The machine will continue to be reported in the balance sheet at cost of £16,000 less accumulated depreciation.

	Depreciation schedule	
		£
Cost of machine		16,000
Depreciation charged on	31/10/2004	3,200
Depreciation charged on	31/10/2005	3,200
Current carrying value		9,600
New residual value		-1,500
New depreciable amount		8,100
New estimated life (in years)		2
So, depreciation for the year ended	01/11/2006	4,050
and, for the year ended	01/11/2007	4,050

The depreciation charge in the profit and loss account for the year ended 31 October 2006 will be £4,050.

In the balance sheet as at 31 October 2006 this asset will be included in tangible fixed assets at cost, £16,000, less accumulated depreciation of £10,450 [£3,200 + £3,200 + £4,050] giving a carrying value of £5,550.

Explanation 2, New depreciable amount 2, New annual depreciation charge 2

(6)

(35)