

Audit and Internal Review (GBR)

AIM

To develop knowledge and understanding of the audit process and its application in the context of the external regulatory framework and for business control and development.

OBJECTIVES

On completion of this paper, candidates should be able to:

- understand the nature, purpose and scope of auditing and internal review, including the role of external audit and its regulatory framework, and the role of internal audit in providing assurance on risk management and on the control framework of an organisation
- identify risks, describe the procedures undertaken in the planning process, plan work to meet the objectives of the audit or review assignment and draft the content of plans
- describe and evaluate accounting and internal control systems and identify and communicate control risks, potential consequences and recommendations
- explain and evaluate sources of evidence, describe the nature, timing and extent of tests on transactions and account balances (including sampling and analytical procedures) and design programs for audit and review assignments
- evaluate findings, investigate inconsistencies, modify the work program as necessary, review subsequent events, and justify and prepare appropriate reports for users within and external to the organisation,

3.6 Advanced Corporate Reporting

2.5 Financial Reporting

1.1 Preparing Financial Statements

3.1 Audit and Assurance Services

2.6 Audit and Internal Review

- including recommendations to enhance business performance
- discuss and apply the requirements of relevant Statements of Auditing Standards
 - demonstrate the skills expected in Part 2.

POSITION OF THE PAPER IN THE OVERALL SYLLABUS

Paper 2.6 builds on the knowledge and understanding developed by Paper 1.1 Preparing Financial Statements and to a limited extent Paper 1.2 Financial Information for Management.

Candidates will be expected to be familiar with Paper 2.5 Financial Reporting, including the requirements of the accounting standards examined within it. They will also be expected to be familiar with Paper 2.1 Information Systems.

Paper 2.6 provides the knowledge and understanding of the audit process which is

then developed in Paper 3.1 Audit and Assurance Services.

SYLLABUS CONTENT

1 Audit framework

- (a) The development and changing nature of audit.
- (b) Statutory audits, accountability, stewardship and agency.
- (c) Professional ethics and codes of conduct, their application to external audit and internal audit, responsibility for fraud and error.

2 Internal audit and internal review

- (a) The role of internal audit and internal review and their relationship with:
 - (i) corporate governance
 - (ii) risk management
 - (iii) organisational control
 - (iv) corporate objectives.

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- (b) Scope and functions of internal audit, the nature and extent of internal audit assignments.
- (c) Outsourced internal audit functions.
- (d) The nature and extent of internal review assignments including operational, systems, value for money and financial reviews.

3 Regulation

- (a) Statements of Auditing Standards:
 - (i) their development and role
 - (ii) their relationship with International Standards on Auditing.
- (b) Auditors:
 - (i) regulation and supervision
 - (ii) their relationship with Government
 - (iii) the role of the Auditing Practices Board and other UK standard-setting bodies.

4 Planning and risk

- (a) Objectives of audit and review assignments, the relevance of stakeholder dialogue.
- (b) Communicating the objectives of audit and review assignments.
- (c) Analytical procedures.
- (d) Risk assessment.
- (e) Materiality, tolerable error, and sample sizes.
- (f) Design and documentation of the plan and work program.
- (g) Co-ordination of the work of others.
- (h) Information technology in planning and risk assessment.

5 Internal control

- (a) Objectives of internal control systems.
- (b) Inherent weaknesses in internal control systems.
- (c) The use of internal control systems by auditors.
- (d) Transaction cycles (revenue, purchases, payroll, stock, capital expenditure).
- (e) The evaluation of internal control systems by auditors including internal control checklists and tests of control.
- (f) Communication with management.

6 Other audit and internal review evidence

- (a) Financial statement assertions: assets, liabilities, income and expenditure, including accounting estimates.
- (b) Assertions reported on and opinions provided in review assignments.
- (c) Analytical procedures as substantive evidence.
- (d) Balance and transaction testing.
- (e) Computer-assisted audit techniques, their uses and limitations.
- (f) Management representations.
- (g) Audit sampling and other selective testing procedures.
- (h) Subsequent events reviews.
- (i) Going concern reviews.
- (j) The overall review of evidence obtained.
- (k) Modifications to the plan and work program in the light of findings.

7 Reporting

- (a) Format and content of unqualified and qualified external audit reports on financial statements.
- (b) Format and content of review reports and other reports on assignment objectives.
- (c) Recommendations for the enhancement of business performance.

EXCLUDED TOPICS

The audit of groups is not examinable at this level. Candidates should be aware of the content, wording and meaning of external audit reports and they may be asked to prepare the explanatory paragraphs for inclusion in a qualified audit report. However, candidates are not expected to draft full external audit reports.

Exposure Drafts (EDs) are not examinable for Paper 2.6.

KEY AREAS OF THE SYLLABUS

The key topic areas are as follows:

- professional ethics as they apply to accountants working in public practice and in business
- risk assessment and the response to assessed risks for external auditors
- the role of internal audit in risk management and corporate governance
- internal controls
- substantive audit evidence.

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APPROACH TO EXAMINING THE SYLLABUS

The examination is a three hour paper constructed in two sections. The bulk of the questions will be discursive but some questions involving computational elements will be set from time to time.

Section A is compulsory. The questions will cover the key elements of the syllabus relevant to both internal and external audit assignments. Section B requires candidates to answer two out of three questions. The questions will cover all areas of the syllabus.

	Number of marks
Section A: 3 compulsory questions (which may be scenario based) (no single question will exceed 25 marks)	60
Section B: Choice of 2 from 3 questions (20 marks each)	40
	100

ADDITIONAL INFORMATION

This paper encompasses:

- 1 Internal review, which may be provided either by internal auditors or may be outsourced to external auditors.
- 2 External audit.

References to audit and auditors mean both internal and external audit and auditors, except where otherwise indicated.

Candidates need to be aware that questions involving knowledge of new examinable regulations will not be set until at least six months after the last day of the month in which the regulation was issued.

The Study Guide provides more detailed guidance on the syllabus. Examinable documents are listed in the 'Exam Notes' section of *student accountant*.

RELEVANT TEXTS

There are a number of sources from which you can obtain a series of materials written for the ACCA examinations. These are listed below:

Foulks Lynch – ACCA's official publisher

Contact number: +44 (0)20 8831 9990.
Website: www.foulkslynch.com

Accountancy Tuition Centre (ATC) International

Contact number: +44 (0)141 880 6469.
Website: www.ptc-global.com

BPP

Contact number: +44 (0)20 8740 2211.
Website: www.bpp.com

The Financial Training Company

Contact number: +44 (0)174 785 4302.
Website: www.financial-training.com

Wider reading is also desirable, especially regular study of relevant articles in ACCA's *student accountant*.

These articles and other communications from the Examiner can be downloaded via the student section of www.accaglobal.com.

STUDY SESSIONS

1 The Nature, Purpose and Scope of Audit and Review

Explain the:

- (a) Nature and development of audit and review
- (b) Concepts of accountability, stewardship and agency
- (c) Concepts of materiality, true and fair presentation and reasonable assurance
- (d) Reporting as a means of communication to different stakeholders
- (e) Need for auditors to communicate with those charged with governance
- (f) High level of assurance provided by audit assignments; the moderate level of assurance provided by review assignments; assignments in which no assurance is provided

NB: Students are expected to be aware of the nature and purpose of non-financial review services as described in Session 6. Internal review questions may deal with these subjects, as well as financial and systems reviews in the context of companies and small not-for-profit organisations

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2 Statutory Audits

Describe the:

- (a) UK regulatory framework in which statutory audits take place
- (b) Development and status of the Auditing Practices Board Statements of Auditing Standards and their relationship with International Standards on Auditing
- (c) Reasons for, and mechanisms for, the regulation of auditors by Government and other regulatory agencies including other UK standard-setters
- (d) Types of opinion provided in statutory audit assignments
- (e) Limitations of statutory audits

3 Internal Audit and Review I

Explain the:

- (a) Meaning of corporate governance and describe corporate governance objectives and the major elements of good corporate governance practice
- (b) Development and role of internal audit in achieving corporate objectives and as part of good corporate governance practice
- (c) Relative merits of out-sourcing internal audit and internal review services to external auditors and others, and the associated problems
- (d) Difference between the role of external audit and internal audit
(Note: Candidates are expected to be aware of the major areas covered by the codes of corporate governance

applicable in the UK (such as the Combined Code) and in particular, the recommendations made in relation to internal audit).

4 Internal audit and Review II

Explain and illustrate the:

- (a) Function of internal audit in the context of corporate risk management and organisational control
- (b) Elements and use of the commonly recognised control frameworks and control components such as those issued in connection with the Combined Code

5 Internal Audit and Review III

Describe the:

- (a) Elements of best practice in the structure and operations of an internal audit function
- (b) Scope of internal audit work and the limitations of the internal audit function
- (c) Types of report provided in internal audit and internal review assignments

6 Internal Audit and Review IV

Describe and illustrate the:

- (a) Nature and purpose of internal review assignments including:
 - (i) value for money
 - (ii) best value
 - (iii) IT
 - (iv) financial

- (b) Nature and purpose of operational internal review assignments including:
 - (i) procurement
 - (ii) marketing
 - (iii) treasury
 - (iv) HR

7 Professional Ethics and Professional Codes of Conduct I

- (a) Describe the sources of, and enforcement mechanisms associated with, professional ethics and professional codes of conduct
- (b) Define the fundamental concepts of professional ethics
- (c) Define the detailed requirements of, and illustrate and analyse the application of, professional ethics in the context of independence, objectivity and integrity
- (d) Distinguish between the elements of professional ethics applicable to internal auditors and those applicable to external auditors
- (e) Describe the responsibilities of internal and external auditors for the prevention and detection of fraud and error and in relation to laws and regulations.

8 Professional Ethics and Professional Codes of Conduct II

- (a) Describe the requirements of professional ethics and other requirements in relation to the acceptance of audit and review

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assignments, including situations in which there is an imposed limitation in audit scope

- (b) Define the detailed requirements of, and illustrate and analyse the application of, professional ethics in the context of confidentiality and conflicts of interest
- (c) Describe the importance of engagement letters and describe their contents

9 Preliminary Planning Procedures

- (a) Distinguish between risk-based, procedural and other approaches to audit and review work
- (b) Describe the sources and nature of information gathered in planning audit and review assignments
- (c) Describe the knowledge of the business required by auditors
- (d) Describe the purpose of analytical procedures in planning and illustrate the application of such procedures
- (e) Describe the components of risk and the use of information technology in risk analysis
- (f) Illustrate and explain the importance of the application of risk analysis
- (g) Define and illustrate the concepts of materiality and tolerable error
- (h) Evaluate misstatements

10 The Work Plan, the Work Program and Documentation

- (a) Describe and illustrate the contents of work plans, work programs and working papers

- (b) Describe the nature of documentation required for different types of assignment
- (c) Explain the importance of documentation
- (d) Illustrate the use of information technology in the audit

11 The Work of Others

Describe the:

- (a) Extent to which external auditors are able to rely on the work of:
 - (i) internal audit
 - (ii) experts
 - (ii) service organisations and recognise where reliance is needed
- (b) Extent to which internal auditors are able to rely on the work of:
 - (i) experts
 - (ii) service organisations
- (c) Conditions that must be met before reliance can be placed on the work of others and the planning considerations in co-ordinating the work of others
- (d) Division of responsibilities between auditors and others
- (e) Extent to which reference to the work of others can be made in audit and review reports

12 Internal Control I

- (a) Describe the objectives of internal control systems and the responsibility for internal control systems in the context of organisational objectives

- (b) Describe the importance of internal control to auditors
- (c) Describe and illustrate the limitations of internal control systems in the context of fraud and error
- (d) Explain the need to modify the audit plan in the light of the results of tests of control
- (e) Distinguish between tests of controls and substantive tests

13 Internal Control II – Sales, Purchases and stock

- (a) Describe, illustrate and analyse how internal control systems over sales, purchases and stock cycles operate in both large and small entities
- (b) Describe and illustrate the use by auditors of internal control checklists for sales, purchases and stock cycles
- (c) Describe and tabulate tests of control of sales, purchases and stock for inclusion in a work program
- (d) Explain and illustrate how structural and operational weaknesses in sales, purchases and stock systems should be reported to management and how recommendations should be made

14 Internal Control III – Revenue

Expenditure and Capital Expenditure

- (a) Describe, illustrate and analyse how internal control systems over revenue and capital expenditure transaction cycles operate in both large and small entities

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- (b) Describe and illustrate the use by auditors of internal control checklists for revenue and capital expenditure transaction cycles
- (c) Describe and tabulate tests of control of revenue and capital expenditure for inclusion in a work program
- (d) Explain and illustrate how structural and operational weaknesses in revenue and capital expenditure systems should be reported to management and how recommendations should be made

15 Internal Control IV – Payroll

- (a) Describe, illustrate and analyse how internal control systems over the payroll transaction cycle operate in both large and small entities
- (b) Describe and illustrate the use by auditors of internal control checklists for the payroll transaction cycle
- (c) Describe and tabulate tests of control of payroll for inclusion in a work program
- (d) Explain and illustrate how structural and operational weaknesses in payroll systems should be reported to management and how recommendations should be made

16 Internal Control V – Bank and Cash

- (a) Describe, illustrate and analyse how internal control systems over the bank and cash transaction cycle operate in both large and small entities

- (b) Describe and illustrate the use by auditors of internal control checklists for the bank and cash transaction cycle
- (c) Describe and tabulate tests of control of bank and cash for inclusion in a work program
- (d) Explain and illustrate how structural and operational weaknesses in bank and cash systems should be reported to management and how recommendations should be made

NB For items 13– 16 an understanding of IT issues and computer controls is required.

17 Other Audit and Review Evidence I

- (a) Describe the sources and relative merits of different types of evidence available
- (b) Describe the financial statement assertions commonly reported on and the principles and objectives of balance and transaction testing
- (c) Distinguish between the interim and the final audit
- (d) Describe and illustrate how analytical procedures are used as substantive procedures
- (e) Explain the problems associated with the audit and review of accounting estimates
- (f) Describe the types of evidence available in smaller entities
- (g) Evaluate the quality of evidence collected

18 Other Audit and Review Evidence II – Debtors and prepayments

- (a) Describe and tabulate for inclusion in a work program the substantive procedures, including debtors circularisations, used in obtaining evidence in relation to debtors and prepayments, and the related income statement entries
- (b) Explain the purpose of substantive procedures in relation to financial statement assertions concerning debtors and prepayments

19 Other Audit and Review Evidence III – Stock

- (a) Explain the importance of stock
- (b) Describe stock counting procedures
- (c) Explain cut-off
- (d) Describe and tabulate for inclusion in a work program the substantive procedures used in obtaining evidence in relation to stock, including the auditors' attendance at stocktaking
- (e) Explain the purpose of substantive procedures including direct confirmation of stock held by third parties, in relation to financial statement assertions concerning stock

20 Other Audit and Review Evidence IV – Current liabilities and accruals

- (a) Describe and tabulate for inclusion in a work program the substantive procedures, including supplier statement reconciliations and

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creditor circulations, used in obtaining evidence in relation to current liabilities and accruals, and the related income statement entries

- (b) Explain the purpose of substantive procedures, in relation to financial statement assertions concerning current liabilities and accruals

21 Other Audit and Review Evidence V – bank and cash

- (a) Describe and tabulate for inclusion in a work program the substantive procedures including bank confirmation reports, used in obtaining evidence in relation to bank and cash, and the related income statement entries
- (b) Explain the purpose of substantive procedures in relation to financial statement assertions concerning bank and cash

22 Other Audit and Review Evidence VI – fixed assets and long-term liabilities

- (a) Describe and tabulate for inclusion in a work program the substantive procedures used in obtaining evidence in relation to fixed assets and long-term liabilities and the related income statement entries
- (b) Explain the purpose of substantive procedures in relation to financial statement assertions concerning fixed assets and long-term liabilities

23 Other Audit and Review Evidence VII

- (a) Explain the need for sampling
- (b) Distinguish between statistical and non-statistical sampling
- (b) Describe and illustrate the application of the basic principles of statistical sampling and other selective testing procedures
- (c) Describe and illustrate the use of computer assisted techniques in obtaining evidence

(Note: candidates will not be required to perform detailed sampling calculations)

24 Going Concern Reviews

- (a) Explain the importance of going concern reviews
- (b) Describe the procedures to be applied in performing going concern reviews
- (c) Describe the disclosure requirements relating to going concern issues
- (d) Describe the reporting implications of the findings of going concern reviews

25 Audit Finalisation and the final review

Describe and explain the:

- (a) Quality of management representations as audit evidence
- (b) Circumstances in which obtaining management representations is necessary and the matters on which representations are commonly obtained

- (c) Purpose of the subsequent events review
- (d) Procedures to be undertaken in performing a subsequent events review
- (e) Importance of the overall review of evidence obtained
- (f) Problems associated with the application of accounting treatments
- (g) Significance of unadjusted differences

26 Reporting I

- (a) Describe, illustrate and analyse the format and content of unqualified and qualified statutory audit reports

27 Reporting II

Describe, illustrate and analyse the format and content of:

- (a) Internal review reports and other reports dealing with recommendations for the enhancement of business performance

28 Not-For-Profit Organisations

- (a) Apply audit and review techniques to small not-for-profit organisations
- (b) Explain how the audit and review of small not-for-profit organisations differs from the audit and review of for-profit organisations