

OPEN COMPETITION EUR/B/164/00
ADMINISTRATIVE ASSISTANTS (B5/B4)

Test d)

Field 02 - Auditing

Test based on a case study, covering several subjects in your chosen field, related to the duties required and designed to test your knowledge of the field and ability to develop ideas formulate them in a clear, logical and structured manner.

Time allowed: 2 hours 30 minutes

YOU MUST ANSWER THE QUESTIONS ON 2 AND ONLY 2 OF THE 3 SUBJECTS OFFERED

(Each of the 2 subjects dealt with will be marked out of 30. The maximum mark for this test will therefore be 60 (pass mark: 30)

DO NOT TURN THE PAGE UNTIL TOLD TO DO SO!

QUESTIONS

1. In general, what are the main objectives of an internal control system for: (8 marks)
 - a) purchases
 - b) payments (for purchases)?
2. Considering the hospital procedures described below, describe, for each of the last six steps (from 3 to 8) of the purchases and payments systems, the internal control procedures that you consider necessary in each of the departments to ensure: (12 marks)
 - segregation of duties
 - that all operations are authorised
 - that all operations are recorded correctly.
3. Describe the tests which you would carry out to ensure that the internal controls operate satisfactorily. (10 marks)

Background

You have just been appointed as the independent auditor of a highly regarded hospital in a European Union Member State. The hospital has been formed as a private legal entity, with a majority of its share capital belonging to the Member State and small minority interests held by three charitable organisations. It is one of the leading European hospitals in cancer treatment and its main activities are in-patient care, out-patient treatment and research activities.

The previous independent auditor has left you a brief overview of the purchases and payments systems:

- 1) When the need arises to replenish materials (including medicines) an internal note is prepared by each of the care and treatment departments and sent to the Central Stores of the hospital.
- 2) Similarly, for the departments carrying out research projects an internal note is sent to the Central Stores. For special materials which are not usually kept by the stores, the internal note is sent directly to the Purchasing Department.
- 3) If the materials are available in the Central Stores, they are sent to the relevant department along with a Goods Forwarded Note. The computerised stock records are updated accordingly.
- 4) Periodically, stock levels are reviewed and, when they are deemed low, a Stock Requisition Form is prepared and sent to the Purchasing Department.
- 5) The Purchasing Department is responsible for choosing the appropriate supplier and for preparing the Purchase Order.
- 6) When materials are received by the Central Stores, a Goods Received Note is prepared and the computerised stock records are amended accordingly. For materials received directly by departments carrying out research projects an Internal Receipt Note is prepared.
- 7) After the receipt of the supplier invoices the Purchasing Department will batch them together and forward them to the Accounts Department for payment. The computerised accounting records are amended accordingly.
- 8) The Accounts Department will prepare the cheques and send them to the suppliers. The computerised accounting records are amended accordingly.

QUESTIONS

1. Following careful review of the financial information presented below:
 - List six matters you would wish as an auditor to raise with senior management. (6 marks) and
 - Justify why you would raise each matter. (12 marks)
2. Explain why an analytical review of financial statements is a necessary part of the auditor's work. (12 marks)

Background

You are the external auditor of Company Y Limited and have to examine the financial statements for the year ended 31 December 2000. The company manufactures household products. You are aware that the company has increased its activity substantially during the year, that it has plans for future expansion and that it intends to request short-term loans following the issue of the audited financial statements.

PROFIT AND LOSS ACCOUNT FOR YEAR ENDED 31/12/2000

	2000 (€)	1999 (€)
Turnover	24 000 000	13 875 000
Cost of Sales (1)	<u>14 500 000</u>	<u>9 712 500</u>
GROSS PROFIT	9 500 000	4 162 500
Distribution Costs (1)	3 280 000	1 110 000
Administrative Expenses (1)	1 300 000	1 200 000
Interest paid	80 000	0
Loss on disposal of fixed assets (2)	<u>2 000 000</u>	<u>200 000</u>
	<u>6 660 000</u>	<u>2 510 000</u>
	2 840 000	1 652 500
Income from investments	<u>50 000</u>	<u>75 000</u>
PROFIT BEFORE TAXATION	2 890 000	1 727 500
Taxation	<u>300 000</u>	<u>900 000</u>
PROFIT AFTER TAXATION	2 590 000	827 500
Dividends proposed	<u>150 000</u>	<u>150 000</u>
Retained profit	2 440 000	677 500
Profit brought forward	<u>5 720 000</u>	<u>5 042 500</u>
Retained profit carried forward	8 160 000	5 720 000

1) Depreciation has been included in the above headings as follows:

	(€)	(€)
Cost of sales	180 000	40 000
Distribution Costs	60 000	50 000
Administrative Expenses	<u>60 000</u>	<u>150 000</u>
	300 000	240 000

2) Net of €100 000 sale proceeds.

BALANCE SHEET AS AT 31/12/2000

	2000	1999
	(€)	(€)
A. FIXED ASSETS		
Tangible assets (3)	3 770 000	3 670 000
Investments	<u>2 600 000</u>	<u>2 600 000</u>
	6 370 000	6 270 000
B. CURRENT ASSETS		
Stock	4 500 000	1 500 000
Trade debtors	3 900 000	1 700 000
Bank	<u>0</u>	<u>400 000</u>
	8 400 000	3 600 000
C. CURRENT LIABILITIES		
Trade creditors	3 500 000	1 100 000
Taxation	300 000	900 000
Dividends	150 000	150 000
Short term bank loans	<u>660 000</u>	<u>0</u>
	4 610 000	2 150 000
D. CAPITAL		
Share capital	2 000 000	2 000 000
Retained profit carried forward	<u>8 160 000</u>	<u>5 720 000</u>
	10 160 000	7 720 000

3) The movement in the fixed assets in the year was as follows:

	<u>Cost</u>	<u>Depreciation</u>	<u>Balance</u>
	(€)	(€)	(€)
Opening balance	5 000 000	(1 330 000)	3 670 000
Additions	2 500 000	0	2 500 000
Disposals	(3 200 000)	1 100 000	(2 100 000)
Depreciation charge	<u>0</u>	<u>(300 000)</u>	<u>(300 000)</u>
Closing balance	4 300 000	(530 000)	3 770 000

QUESTIONS

As a newly appointed internal auditor in an International European Institution you come across each of the scenarios described below. For each scenario you are asked to prepare a brief Note for your head of department, giving:

- a) the main points to audit**
- and**
- b) any recommendations concerning the control environment**

Each scenario is separate and independent. Justify your replies with any quantitative and qualitative elements that you consider necessary based on the information given below, and indicate any matters that need to be clarified in order to identify risk factors (financial or other) more clearly.

Scenario 1 (15 Marks)

The International Institution has an Annual Service Contract with a medium-sized company to supply statistics to 400 offices/organisations in all its member states. Under entirely different contracts, the International Institution makes payments to each of the 400 offices for disseminating the statistics within each country.

The Annual Service Contract is for €900 000/year and may be renewed up to a maximum of 3 times.

The Annual Service Contract does not include the office rental, which is charged separately to the International Institution by the contractor. All travel costs included in the Annual Service Contract require the prior approval of the International Institution (which takes a minimum of 10 working days). Subcontracting for minor tasks is allowed under the Annual Service Contract.

Every 3 months the contractor submits all the time sheets of all the personnel declared by his company (the main contractor) and by subcontractors for countersigning by the head of the service supervising the Annual Service Contract in the International Institution. Once they have been countersigned, the Contractor may then issue his quarterly invoice; under the Annual Service Contract, the invoice should be paid within 60 days. The contractor issues a summary report with the invoice, describing the main activities during the invoiced period.

Scenario 2 (15 Marks)

The International Institution gives a grant every year of €450 000 to a non-profit confederation of European Product-XXX Makers to organise and hold an international conference of Product-XXX Makers from Europe, the US and Japan. International Institution staff and representatives of European countries also participate. The conference takes place in expensive locations, but is always well attended and considered of great importance by the International Institution staff who attend.

The Product-XXX Makers Confederation was founded by a former senior staff member of the International Institution. The Confederation does not have a lot of financial resources, but the industry supporting it does. The Confederation has 2 full-time employees, with additional staff supplied by the Product-XXX Makers.

SUBJECT 3 (cont'd)

The Product-XXX Makers Confederation must find other sponsors in order to match the International Institution's contribution, which is set at 50% of the total costs of the conference. The grant cannot be used to cover the participation costs of non-Europeans. The Product-XXX Makers donate free of charge the necessary secretarial and clerical assistance for the organisation of the conference each year.

The grant is awarded on the condition that there is no profit and that the actual costs declared can be audited. The budget and actual costs declared can include publications, catering, travel, interpretation facilities, etc.