# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

## SKILL LEVEL EXAMINATION- PILOT QUESTIONS AND SOLUTIONS

## AUDIT, ASSURANCE AND FORENSICS

**Time allowed: 3¼ hours (including 15 minutes reading time)**

**INSTRUCTION:** **YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF THE SEVEN QUESTIONS IN THIS PAPER**

**SECTION A:** **COMPULSORY QUESTION** **(30 MARKS)**

**Question 1**

**Preparation for statutory audit and board member orientation**
**Upcoming Audit of Yanki Plc**
The annual audit for Messrs Yanki Plc is scheduled to begin soon. The company has experienced positive business growth over the past year, with projected increases in both turnover and profits as highlighted by the directors in their recent board meeting.

**Changes on the board of directors**
Several new members have been elected to the board, each representing various groups of shareholders. Notably, two of these individuals bring extensive experience from state and local government administration and are currently familiarising themselves with the complexities of the corporate sector.

**Timely commencement and compliance**
During the last board meeting, the directors emphasised the importance of starting the audit promptly. This is to ensure all necessary compliance measures are met.

**Orientation for new board members**
One of the newly appointed board members has reached out to your managing partner, expressing interest in understanding several aspects of the statutory audit process. The managing partner has referred these inquiries to you, requesting that you prepare to discuss the essential topics that were identified as important for the new board member's orientation.

**Required:**

**a.** Prepare a material to present to him the advantages and limitations of the statutory audit **(5 marks)**

**b.** Explain the control environment under which financial statements are prepared and the need to evaluate such control environments. **(15 marks)**

**c.** Explain the methods of selection of samples to meet the audit exercise in accordance with ISA 530 – Audit Sampling. **(10 marks)**

**(Total 30 marks)**

**SECTION B: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THREE QUESTIONS IN THIS SECTION (40 MARKS)**

**Question 2**

The field work of the audit of Maikudi Survival Limited has been completed, and the file is now being prepared for reviews of the compliance and engagement partners.

**Required:**

**a.** State the materials to be included in both the current and permanent files of the company to meet basic minimum requirements of audit documentation. **(12 marks)**

**b.** Explain the term "assurance" and the related levels of assurance. **(8 marks)**

**(Total 20 marks)**

**Question 3**

You are the lead auditor for Debacco Technologies, a mid-sized software development company specialising in cloud-based enterprise solutions. The company has recently expanded its operations internationally, and this is your first engagement as their external auditor. Debacco Technologies processes significant amounts of sensitive client data and has recently implemented several new IT systems to support its growth. The audit team must ensure a thorough risk assessment, robust IT governance, and strict adherence to NOCLAR (Non-Compliance with Laws and Regulations) requirements throughout the engagement.

**Required:**

**a.** State the risk assessment procedures for your client to ensure a risk free audit. **(6 marks)**

**b.** Present IT governance systems to ensure a hitch free processing. **(5 marks)**

**c.** List the requirements of NOCLAR that should be observed. **(9 marks)**

**(Total 20 marks)**

**Question 4**

Alabi & Co., Chartered Accountants, are the auditors of Tochukwu Industries Limited. The firm has served the company for some years. However, the company decided to appoint your firm, Johnson, Ebube & Co., Chartered Accountants. A review of the records and activities of the company in the past highlighted the following:

i. The same staff of Alabi & Co were preparing the accounts and carrying out the audit function;
ii. Most of the transactions were not recorded but were given verbally by the MD/CEO;
iii. There were no internal audit activities in the company.

The company now wants to have a more reliable auditing process that will indicate the state of affairs of the company and hence the appointment of your firm.

**Required:**

**a.** Discuss the fundamental principles in the code of ethics of accountants as contained in both IFAC and ICAN code for members. **(8 marks)**

**b.** State the threat that is inherent in the scenario above for the outgoing auditor and relevant exemptions. **(5 marks)**

**c.** Explain the term "sufficient" and "appropriate" in the evidence the auditor needs to gather for his opinion. **(4 marks)**

**d.** Recognising that Tochukwu Industries Limited is a trading concern, state the principal controls in the accounting system that would be necessary. **(3 marks)**

**(Total 20 marks)**

## SECTION C: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THREE QUESTIONS IN THIS SECTION. (30 MARKS)

### Question 5

The auditors are in the process of completing the engagement of one of their clients and there is the need to ensure compliances with both the law and standards. While this preparation is being made, one of the fresh trainees got curious and was asking about the duties and responsibilities of the auditor. You are the most experiences trainee handling this phase of the work.

**Required:**

**a.** Outline the statutory duties of the auditor to the audit client. **(7 marks)**

**b.** Present the responsibilities of the auditor with respect to misstatements in the financial statements. **(8 marks)**

**(Total 15 marks)**

### Question 6

Turn-It-Right Limited is having issues with the balances in some of the current asset accounts in the books of the company. While some records show that there are improvements, the company is having difficulties in meeting obligations and, particularly, finding funds for activities.

There are also growing indications among the staff, that there are suspicious transactions between the accountant and some other senior staff. The chief executive officer has threatened to prosecute any person found culpable from an investigation to be conducted. You have been brought in to conduct a detailed exercise of the source of the challenges.

**Required:**

**a.** List the items the accountant carrying out this investigation would need to put together to ensure evidence presentation if called up on this case in court. **(12 marks)**

**b.** State the categories the financial statement assertion may fall, giving one example under each category. **(3 marks)**

**(Total 15 marks)**

### Question 7

The audit of Kaleri Trading Company Limited during the last year disclosed a lot of inappropriate recordings of transactions, leading to longer time on the audit than was projected. However, due the level of the accounting knowledge of the chairman, it was difficult to recover the cost of the accounting services rendered before the audit was done.

Discussion were held with the chairman and it was agreed that an internal audit unit be set up for the company. The position was advertised and somebody was employed who commenced work for some time before the end of the current audit.

**Required:**

**a.** Discuss the overall audit strategy to be subsequently adopted andthe plan for the current audit. **(8 marks)**

**b.** Evaluated the basis for assessing the impact of the Internal audit. **(4 marks)**

**c.** Explain the benefits of outsourcing the internal audit function. **(3 marks)**

**(Total 15 marks)**

## SUGGESTED SOLUTIONS

### Solution 1

**a.** Advantages of statutory audits

i. An external audit provides the following benefits:

ii. It increases the credibility of published financial statements.

iii. It confirms to management that they have performed their statutory duties correctly.

iv. It provides assurance to management that they have complied with non- statutory requirements, such as corporate governance requirements (where these are subject to audit or review).

v. It provides feedback on the effectiveness of internal controls. Where internal controls are weak or inadequate, the auditor will give recommendations for improvement. This will assist management in reducing risk and improving the performance of the company.

The main limitations of an audit are as follows:

i. Its cost. The cost of an audit can be very high. However, if the audit firm is already hired to carry out non-audit work such as accounts preparation or advisory work, the additional cost of an audit may be fairly small.

ii. The disruption caused to a company's staff during the audit. The company's staff may be required to assist the auditors by answering questions, providing documents and other information.

iii. Some items in the subject matter might be estimates whose truth and fairness will not be known with certainty until some point in the future. This means the assurance opinion is ultimately subjective and judgmental.

iv. Most fraud will include an attempt to deliberately conceal the truth or misrepresent information.

v. In order to balance cost and efficiency the auditor routinely uses sampling rather than tests every item.

vi. Irrespective of how robust a client's systems are they will always incorporate some degree of inherent limitation.

vii. Audit evidence is persuasive rather than conclusive.

**b.** The 'control environment' is often referred to as the general 'attitude' to internal control of management and employees in the organisation.

The control environment includes the views, awareness and actions of management regarding an entity's internal control. It also includes the governance and functions of management and asserts the premise of an organisation. It is the basis for good internal control, providing guidance and structure.

The control environment includes the following elements:

i. Communication and enforcement of integrity and ethical values;

ii. Commitment to competence;

iii. Participation of management;

iv. Management's philosophy and operating style;

v. Organisational structure;

vi. Assignment of authority and responsibility; and

vii. Human resource policies and practices.

A strong control environment is typically one where management shows a high level of commitment to establishing and operating appropriate controls.

The existence of a strong control environment cannot guarantee that controls are operating effectively, but it is seen as a positive factor in the auditor's risk assessment process. Without a strong control environment, the control system as a whole is likely to be weak.

ISA 315 requires auditors to gain an understanding of the control environment. Part of this understanding involves the auditor evaluating the control environment, and assessing its effectiveness.

In evaluating the control environment, the auditor should consider such factors as:

i. management participation in the control process, including participation by the board of directors;
ii. management's commitment to a control culture;
iii. the existence of an appropriate organisation structure with clear divisions of authority and responsibility;
iv. an organisation culture that expects ethically-acceptable behaviour from its managers and employees; and
v. appropriate human resources policies, covering recruitment, training, development and motivation, which reflect a commitment to quality and competence in the organisation.

**c.** if an audit sampling exercise is to be effective – if sampling risk is to be reduced and therefore detection risk reduced – the sample must be designed in an appropriate way.

When designing a sample, the auditor is **required** by ISA 530 to:

i. consider the purpose of the audit procedure and the population from which the sample will be drawn;

ii. determine a sample size sufficient to reduce sampling risk to an acceptably low level; and

iii. select items for the sample in such a way that each sampling unit in the population has an equal chance of selection.

The auditor will therefore have to make a number of key decisions:

i. the sampling approach to be used (statistical or non-statistical);

ii. the characteristics of the population from which the sample is to be drawn;

iii. the sample selection method;

iv. what constitutes a misstatement or deviation;

v. the ‘tolerable’ misstatement or rate of deviation; and

vi. the ‘expected’ misstatement or rate of deviation.

All of the above decisions will influence the sample size required.

**Solution 2**

**a.** Audit documentation may be recorded on **paper**, or on **electronic or other media**. The audit documentation for a specific engagement is assembled in an **audit file.** The precise contents of the audit file varies, depending on the nature and size of the client and the complexity of the audit processes required to reach a conclusion but will include:

i. audit programs;
ii. analyses;
iii. summaries of significant matters;
iv. letters of confirmation and representation;
v. checklists; and
vi. correspondence.

Traditionally, it has been normal practice in the case of on-going audits to maintain two types of audit files:

i. a permanent file; and
ii. a current file.

**Permanent file**

The permanent file records information that is likely to be of significance to **every** annual audit of that client. Examples of such information might include:

i. the legal constitution of the company;

ii. other important legal documents such as loan agreements;

iii. a summary of the history, development and ownership of the business;

iv. a summary of accounting systems and procedures; and

v. copy of previous year’s financial statements, together with key ratios and trends.

**Current file**

The current file contains information of relevance to the **current** year’s audit. This is the evidence on which the conclusion of the current audit will be primarily based. Examples of the contents of a current audit file include the following:

i. The final financial statements and audit report;
ii. A summary of audit adjustments, including those not included in the final reported figures.
iii. Audit planning material (the audit plan, materiality threshold calculations, risk assessments);
iv. Audit control material (these are items used to control the progress of the audit, such as time budgets, review points, and points for consideration by the audit partner);
v. Audit letters (e. g. engagement letter, letter of representation, management letter); and
vi. For each audit area (for example, inventory, receivables).

- an audit programme (detailing the work to be done on that area);
- details of items selected for testing, the tests performed, problems encountered (together with their resolution) and the conclusion reached on that area; and
- 'lead schedules' giving the figures for the audit area, as they appear in the final financial statements, cross-referenced to relevant audit tests.

**b.** 'Assurance' means confidence.

In an assurance engagement, an 'assurance firm' is engaged by one party to give an opinion on a piece of information that has been prepared by another party. The opinion is an expression of **assurance** about the information that has been reviewed. It gives assurance to the party that hired the assurance firm that the information can be relied on.

Assurance can be provided by:

i. **audit**: this may be external audit, internal audit or a combination of the two
ii. a review.

A statutory audit is one form of assurance. Without assurance from the auditors, the shareholders may not accept that the information provided by the financial statements is sufficiently accurate and reliable. The statutory audit provides assurance as to the quality of the information.

The provision of this assurance should add credibility to the information in the financial statements, making the information more reliable and therefore more useful to the user.

However, there are differing levels or degrees of assurance. Some assurances are more reliable than other

**Levels of assurance**

The degree of assurance that can be provided about the reliability of the financial statements of a company will depend on:

i. the amount of work performed in carrying out the assurance process, and

ii. the results of that work.

The resulting assurance falls into one of two categories:

**i.** Reasonable Assurance – A high (but not absolute) level of assurance provided by the practitioner's conclusion expressed in a **positive form**. E.g. "*In our opinion the accounts are true and fair*". The objective of a statutory audit is to provide reasonable assurance.

**ii.** Limited Assurance – A moderate level of assurance provided by the practitioner's conclusion expressed in a **negative form**. E.g. "*Based on our review, nothing has come to our attention that causes us to believe that the accompanying financial statements do not give a true and fair view*". The objective of a review engagement is often to provide limited assurance.

**Solution3**

**a.** Identifying risks means recognising the existence of risks or potential risks. Assessing the risks means deciding whether the risks are significant, and possibly ranking risks in order of significance. Managing risks means developing and implementing controls and other measures to deal with those risks.

ISA 315 requires the auditor to gain an understanding of these risk assessment processes used by the client company's management, to the extent that those risk assessment processes may affect the financial reporting process.

Risks can arise or change due to circumstances such as:

i. changes in the entity's operating environment;
ii. new personnel;
iii. new or revamped information systems;
iv. rapid growth;
v. new technology;
vi. new business models, products or activities;
vii. corporate restructurings;
viii. expanded foreign operations; and
ix. new accounting pronouncements.

Components of the governance system (7 components formerly known as 7 enable

To satisfy governance and management objectives, each enterprise needs to establish, tailor and sustain a governance system built from a number of components.

These components have the following characteristics:

i. Components are factors that, individually and collectively, contribute to the good operation of the enterprise governance system over IT;
ii. Components interact with each other, resulting in a holistic governance system for IT; and
iii. Components can be of different types. The most familiar are processes. However, components of a governance system also include organisational structures; policies and procedures; information items; culture and behaviour; skills and competencies; and services, infrastructure and applications.

The components are as follows:

i. Processes describe an organised set of practices and activities to achieve certain objectives and produce a set of outputs that support achievement of overall IT-related goals;
ii. Organisational structures are the key decision-making entities in an enterprise;
iii. Principles, policies and frameworks translate desired behaviour into practical guidance for day-to-day management;
iv. Information is pervasive throughout any organisation and includes all information produced and used by the enterprise. COBIT focuses on information required for the effective functioning of the governance system of the enterprise;
v. Culture, ethics and behaviour of individuals and of the enterprise are often underestimated as factors in the success of governance and management activities;
vi. People, skills and competencies are required for good decisions, execution of corrective action and successful completion of all activities; and
vii. Service, infrastructure and application include the infrastructure, technology and

application that provide the enterprise with the information system for IT processing.

**b.** The IFAC Code provides additional guidance for all professional accountants on how to respond when encountering non-compliance with laws and regulations (NOCLAR).
This non-compliance can be intentional or non-intentional and examples include:

i. Fraud, corruption and bribery;
ii. Money laundering, terrorist financing and proceeds of crime;
iii. Securities markets and trading;
iv. Banking and other financial products and services;
v. Data protection;
vi. Tax and pension liabilities and payments;
vii. Environmental protection; and
viii. Public health and safety.

The NOCLAR framework explains:

The process to be followed when a professional accountant encounters a suspected fraud or illegal act (i.e. NOCLAR);and

i. The circumstances in which a professional accountant would override the fundamental principle of confidentiality and disclose the matter to an appropriate authority (also known as whistle-blowing).
ii. Under the framework, auditors cannot simply resign from an engagement because of identified or suspected NOCLAR without the matter being appropriately addressed.

**Solution 4**

**a.** There are five **fundamental principles** in The Code.
These are set out below.

i. **Integrity**. Members shall be straightforward and honest in all professional and business relationships. Integrity implies not just honesty but also fair dealing and truthfulness.
ii. **Objectivity**. Members are not to compromise professional or business judgements because of bias, conflict of interest or undue influence of others.
iii. **Professional competence and due care**. Members have a duty to attain and maintain their professional knowledge and skill at the level required to ensure that a client or employer receives a competent professional service, based on current technical and professional standards and relevant legislation. Members shall act diligently and in accordance with applicable technical and professional standards.
iv. **Confidentiality**. Members shall respect the confidentiality of information acquired as a result of professional and business relationships and shall not disclose such information to third parties without authority or unless there is a legal or professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships must not be used for the personal advantage of members or third parties.

v. **Professional behaviour**. Members shall comply with relevant laws and regulations and avoid any conduct the professional accountant knows or should know might discredit the profession.

**b.** Preparing accounting records and financial statements and then auditing them creates a significant **self-review threat**. This may also apply where an assurance engagement involves reviewing subject matter (such as forecasts) prepared by the firm itself.

In providing such assistance, firms **must not make management decisions** such as:

i. determining accounting policies;
ii. deciding on or changing journal entries without the client's approval;
iii. authorising or approving transactions; and
iv. preparing source documents or originating data (including decisions on valuation assumptions).

The provision of advice on accounting principles and presentation in the financial statements given during the course of an audit will not generally threaten the firm's independence as long as the client is responsible for making all decisions. Such advice is considered to be part of the normal audit process.

**c.** Sufficient and appropriate evidence.

**Sufficient** relates to the **quantity** of evidence.
**Appropriate** relates to the **quality** (relevance and reliability – see below) of the evidence.

The auditor will need to exercise professional judgement on both of these aspects; the quantity and the quality of evidence.

i. When is there enough evidence to support a conclusion?
ii. What is the quality of a given piece of evidence, and is this sufficient to justify the audit opinion?

The two characteristics of quantity and quality are also inter-related:

i. An auditor may be able to reach a conclusion based on a smaller quantity of high quality evidence,

ii. but a larger quantity of lower quality evidence may be required to reach the same conclusion

**c.** Suitable controls may be as follows:

i. There should be a segregation of duties, and the individuals who process orders from customers should not also carry out credit reference checks on new customers or credit limit checks on existing customers. The latter could be done manually by reference to a file of approved credit limits, or it could be a programmed control whereby the system will only accept an order if the customer will still be within his credit limit;

ii. All new customer accounts, and their credit limit, should be authorised;

iii. Orders should be recorded on sequentially-numbered documents or the system should allocate sequential numbers to documents; and

iv. For every sales order, a despatch note should be produced (manually or generated by the system from the order details). Goods should not be despatched to customers without a dispatch note.

**Solution 5**

**a.** The primary duty of the external auditor is to:

i. examine the financial statements, and
ii. issue an auditor's report on the financial statements, which is then presented to the shareholders together with the financial statements.

This auditor's report will set out the auditor's opinion as to whether (or not) the financial statements:

i. give a true and fair view (or "present fairly") the financial position and performance of the company, and

ii. have been prepared in accordance with the applicable financial reporting framework.

S.407 CAMA 2020 requires the auditor to form an opinion on matters stated in schedule 5 (s404(2)) to CAMA 2020 as provided below.

i. Whether the auditors' have obtained all the information and explanations which to the best of their knowledge and belief were necessary for the purpose of their audit;
ii. Whether, in the auditors' opinion, proper books of account have been kept by the company, so far as appears from their examination of those books, and proper returns adequate for the purposes of their audit have been received from branches not visited by them;
iii. Whether the company's statement of financial position and (unless it is framed as a consolidated profit and loss account) profit and loss account dealt with by the report agree with the books of account and returns;
iv. Whether, in the auditors' opinion and to the best of their information and according to the explanations given them, the said statements give the information required by the Act in the manner so required and give a true and fair view in the case of :
    - the statement of financial position, of the state of the company's affairs as at the end of its year;
    - the profit and loss account, of the profit and loss for its year; or as the case may be, give a true and fair view thereof subject to the non-disclosure of any matters (to be indicated in the report) which, by virtue of Part I of the Second Schedule of the Act, are not required to be disclosed;
    - In the case of a holding company submitting group financial statements whether, in their opinion, the group financial statements have been properly prepared in accordance with the provisions of this Act so as to give a true and fair view of the state of affairs and profit or loss of the company and its subsidiaries and associates.

The auditor's report must state if any of the above were not met.
The outcome of the statutory audit is an **opinion** on the truth and fairness of the financial statements.
The word 'opinion' implies that the auditor has applied his professional judgement in reaching his conclusion.

**b.** ISA 450 **requires** the auditor to do the following:

i. Accumulate all misstatements found during the audit, unless they are clearly trivial;

ii. If the total of misstatements identified during the audit approach (or could approach) materiality, decide if the overall audit strategy and audit plan need to be revised;

iii. Communicate all misstatements found during the audit to an appropriate level of management and request that the misstatements be corrected;

iv. If management refuse to correct the misstatements obtain the reasons for this and take those reasons into account when evaluating whether the financial statements as a whole are free from material misstatement;

v. Prior to evaluating the effect of uncorrected misstatements reassess materiality per ISA320;

vi. Decide whether uncorrected misstatements are material, individually, or when added together. In making this assessment the auditor should take into account the size, nature and circumstances of the misstatements and the effect of any uncorrected misstatements from prior periods;

vii. Communicate to those charged with governance the effect that uncorrected misstatements may have on the auditor's report;

viii. Request a written representation from management as to whether they believe the effect of uncorrected misstatements are immaterial, individually, or in total;

ix. Document:

- the amount below which misstatements would be regarded as clearly trivial;
- all misstatements accumulated during the audit and whether they have been corrected;
- his conclusion as to whether uncorrected misstatements are material, individually, or in total.

**Solution 6**

**a.** The materials to be put together include:

i. research;
ii. accounting, banking and other business records, and agreements;
iii. pleadings, criminal or regulatory charges, and other legal claims;
iv. affidavits and discovery transcripts;
v. engagement letters and other correspondence;
vi. reports issued;
vii. schedules and calculations, including all necessary explanations;
viii. notes and other recordings of interviews, meetings and discussions;
ix. documentation of key issues considered and key assumptions made;
x. the approach(es) taken and specific techniques used;
xi. a record of the nature, extent and timing of procedures performed and the results of such procedures;
xii. a record of the identities of the individual(s) performing the IFA engagement and a record that the work performed by assistants was supervised and reviewed; and
xiii. where the work of others is relied upon, their findings and conclusions.

**b.** Financial statement assertions fall into three categories:

i. **classes of transactions or events** (income statement)assertions:

- occurrence;
- completeness;
- accuracy;
- cut-off; and
- classification.

ii. **account balances** (statement of financial position) assertions:

- existence;
- rights and obligations;
- completeness; and
- valuation.

iii. **presentation and disclosure** assertions:

- occurrence and rights and obligations;
- completeness;
- classification and understandability; and
- accuracy and valuation.

**Solution 7**

**a.** The overall audit strategy sets the **scope, timing and direction of the audit** and **guides the development of the more detailed audit plan.**

The establishment of the overall audit strategy involves the following:

i. Determining the characteristics of the engagement that define its **scope** such as:

- the financial reporting framework used (for example, international financial reporting standards);
- any industry specific reporting requirements; and
- the location of the components of the entity (for example, there might be overseas branches).

ii. Ascertaining the **reporting objectives** of the engagement, such as reporting deadlines and the nature of communications required.
Considering **important factors** which will determine the focus of the audit team's efforts, such as:

- materiality thresholds;
- high risk areas of the audit;

- the audit approach (for example, whether the auditor is planning to rely on the entity's internal controls); and
- any recent developments in relation to the entity, the industry or financial reporting requirements.

The above will then allow the auditor to decide on the **nature, extent and timing of resources** needed to perform the engagement. In particular the auditor should consider:

- where experienced members of staff may be needed (for example, on high risk areas);
- the number of staff to be allocated to specific areas (for example, extra staff may be needed for attendance at the year-end inventory count);
- when the resources are needed (for example, are more staff needed at the final audit than at the interim audit); and
- how such resources are to be managed, directed and supervised (for example, the timing of team briefing meetings and manager and partner reviews of work performed by other members of the audit team).

**The audit plan**

Once the overall audit strategy has been established the auditor can develop the more detailed audit plan.

The audit plan will set out:

i. the procedures to be used in order to assess the **risk of misstatement** in the entity's accounting records/financial statements; and
ii. planned **further audit procedures** for each material audit area. These audit procedures might be in response to the risks assessed, or specific procedures to be carried out to ensure that the engagement complies with ISAs.

The audit procedures to be performed by audit team members will be those needed in order to:

- obtain sufficient appropriate audit evidence; and
- reduce audit risk to an acceptably low level.

**b.** Clearly, there is a potential problem with objectivity and independence in the case of an internal auditor, because he is (usually) an employee of the company.

In order to operate effectively, internal auditors need a degree of independence within the structure of the organisation. This may be achieved in any of the following ways:

i. The internal audit department should be responsible to and accountable to members of senior management who have no financial responsibilities. For example, the internal audit function might report directly to the audit committee. Alternatively, the internal audit department may report to a senior executive manager such as the finance director, but in addition should be required to report periodically to the audit committee;
ii. Internal auditors should not be involved in carrying out non-audit tasks. Their independence can be protected to some extent by making them audit specialists; and
iii. Internal auditors should have unrestricted access to the information necessary to their

audit work; and

iv. The internal audit department should have the support of management at all levels.

The IIA has issued ethical guidance for its members that are broadly similar to the guidance issued by ICAN.

**c. Benefits of outsourcing internal audit**

There are several advantages of outsourcing internal audit work:

i. **Staff recruitment**. There is no need for the company to recruit and train its own internal audit staff. An internal audit function can be instantly available by hiring the services of an accountancy firm;

ii. **Auditor skills**. The outside supplier is likely to have specialist staff available, such as computer audit experts. Internal auditors with an IT specialisation may be difficult to recruit as full-time employees;

iii. **Costs and flexibility**. The cost of the internal audit function is a variable cost rather than a fixed cost. A company therefore only pays for the internal audit time that it uses; and

iv. Outsourcing is likely to be more economical for a small entity that does not have enough audit work to justify a full time internal audit team.