

## AUI2601

May/June 2017

### INTERNAL AUDITING: THEORY AND PRINCIPLES

Duration 2 Hours

100 Marks

**EXAMINERS**

FIRST

MRS BM VAN WYK

SECOND

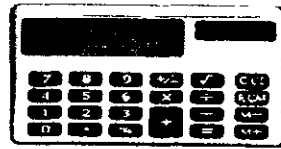
MS M EDWARDS

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**Use of a non-programmable pocket calculator is permissible**

**Closed book examination**

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THIS PAPER CONSISTS OF **NINE (9)** PAGES

| QUESTION | MAIN TOPIC                                       | MARKS      |
|----------|--|------------|
| 1        | Multiple-choice questions                        | 18         |
| 2        | Reporting lines of Internal Audit                | 10         |
| 3        | The internal audit process                       | 20         |
| 4        | Code of Ethics                                   | 15         |
| 5        | Responsibilities and functions of internal audit | 37         |
|          |  | <u>100</u> |

**NOTE**

Although the primary purpose of the examination is to test the candidate's knowledge and ability to apply the subject matter, the examiners will also take into consideration his or her ability to organise and present this knowledge in acceptable, written English

[TURN OVER]

**QUESTION 1**

**18 marks**

**REQUIRED**

For each subsection of this question, select only **one** alternative that you consider to be the most correct alternative. Then write down, as your answer, the number of the subsection and the letter that precedes your selected alternative. Answer the subsections of this question in numerical sequence, for example

- 1.1 A
- 1.2 B

Each question counts for 1½ marks

1.1 Internal and external audit work should be coordinated to ensure adequate audit coverage and to eliminate unnecessary duplication of effort. Which one of the following alternatives involves the coordination of audit effort?

- A Exchange of audit reports on matters of mutual interest
- B Periodic meetings to discuss general economic growth and market direction
- C Common understanding of the respective audit reports and presentations to management
- D Dual use of audit clerks for audit activities

1.2 Which one of the following factors is essential in evaluating the competence/appropriateness of audit evidence? The evidence must

- A be well documented and cross-referenced in the working papers
- B be based on the best available evidence that is considered appropriate
- C bear a direct relationship to the finding and include all of the elements of a finding
- D be convincing enough for a prudent person to reach the same conclusion as the internal auditor

1.3 According to the International Standards for the Professional Practice of Internal Auditing (*Standards*), due professional care calls for

- A detailed audits of all transactions related to a particular function
- B infallibility and extraordinary audit performance when the system of internal control is inadequate
- C consideration of the possibility of material errors and irregularities during an audit assignment
- D testing transactions in sufficient detail to give absolute assurance that noncompliance does not exist

**[TURN OVER]**

- 1.4 An internal auditor with a Certified Internal Auditor (CIA) qualification applied for a new position with another company as the director of purchasing. Within a month of his appointment, the director signed a contract to procure a large order from a new supplier with the best tender in terms of price, quality, and delivery. Shortly after signing the contract, the supplier presented the director with a voucher for a weekend breakaway on a game farm. Which one of the following statements with regard to the acceptance of the gift is **incorrect**?
- A Acceptance of the gift would violate the Institute of Internal Auditor's Code of Ethics and would be prohibited for a CIA, even though he were not acting as an internal auditor
  - B Acceptance of the gift would be acceptable if it was customary for directors to receive gift vouchers
  - C Because the director is no longer acting as an internal auditor, although holding a CIA designation, acceptance of the gift would also be governed by the organisation's code of conduct
  - D Because the contract had been signed before the gift was offered, acceptance of the gift would violate the Institute of Internal Auditor's Code of Ethics and possibly the organisation's code of conduct
- 1.5 Which one of the following activities is **not** included in developing the internal audit department's long-term audit plan and schedules?
- A Developing audit programmes
  - B Assessing risk factors identified
  - C Planning workload requirements
  - D Identifying auditable locations
- 1.6 The most important benefit provided by the audit committee to the internal auditor is to
- A protect the independence of the internal auditor from undue management influence
  - B review annual audit plans and to monitor audit results
  - C approve audit plans and to schedule meetings with the internal auditor
  - D review copies of the procedural manuals for selected company operations and discuss such manuals with a company official

[TURN OVER]

- 1.7** Indicate the alternative that **correctly** completes the following sentence  
The fact that internal auditors customarily have a dual relationship with executive management and the audit committee means that
- A executive management should help the internal auditors by revising and forwarding operational audit reports to the audit committee
  - B the internal auditors should audit operations, check the accuracy of the report with operational management, and then report to executive management and the audit committee
  - C the internal auditors work under the control of the audit committee, but report to the chief operating officer on all operational audits
  - D the internal auditors should audit operations and report directly to the audit committee, without discussing the report with executive management
- 1.8** Internal audit's working papers have the following characteristics
- A they are the property of the organisation and are available to all the company employees
  - B they become the property of the independent external auditors when completed.
  - C they should be retained permanently in the organisation's records
  - D they document the auditing procedures performed, the information obtained and the conclusions reached
- 1.9** When compared with the objectives of external auditors, the objectives of internal auditors focus more on
- A communicating findings to the managers of the various business processes and organisational units
  - B the substantiation and presentation of financial statements
  - C assisting members of the organisation to meet their responsibilities and management's needs
  - D developing and implementing internal accounting controls

[TURN OVER]

- 1.10** During the internal audit of sales representatives' travel expenses, the internal auditor calculates the average travel expenses per day for each of the sales representatives. He then examines the detailed receipts for sales representatives who have high daily averages. These audit procedures represent the use of which of the following types of audit evidence?
- A physical and oral evidence
  - B analytical and documentary evidence
  - C analytical and physical evidence
  - D documentary and physical evidence
- 1.11** An element of authority attributed to the internal audit activity that should be included in their charter is the
- A establishment of the internal audit activity's position within the organisation
  - B identification of the organisational units where internal audit engagements must be performed and the frequency of such engagements
  - C identification of the different types of disclosures that must be made to the audit committee
  - D access to the external auditor's working papers and engagement letter
- 1.12** Working papers should be disposed of when they are of no further use. Retention policies
- A should be approved by top management and compiled according to the legal requirements
  - B should be approved by the external auditor
  - C should be prepared by the audit committee
  - D should specify a minimum retention period of three years

**QUESTION 2**

**10 marks**

Dreams Discovered Ltd manufactures and sells children's toys. You are the newly appointed Chief Audit Executive (CAE) for the recently established internal audit activity in the company. The board and Chief Executive Officer (CEO) are in dispute over who the CAE should report to and have asked for your guidance in the matter.

**REQUIRED**

**Marks**

- 2.1** Discuss the advantages and disadvantages of reporting to the Audit Committee (3)

**[TURN OVER]**

- 2.2 Discuss the advantages and disadvantages of reporting to the CEO (3)
- 2.3 According to the IIA Standards, recommend what type of reporting is preferred for independence purposes (4)

**QUESTION 3**

**20 marks**

You act as a mentor to the junior internal auditors in your internal audit department. Part of your responsibility is to assist them with their studies and other aspects regarding their training as internal auditors.

**REQUIRED**

**Marks**

Answer the following questions posed to you by a new junior internal auditor during a mentoring session.

- 3.1 The internal audit process consists of four (4) phases. The second phase is planning the internal audit (engagement planning). According to the IIA Standards 2201 – Planning Considerations, what does the internal auditor need to consider when planning the engagement? (4)
- 3.2 Identify four (4) different types of audit evidence? Define the different kinds of evidence with an example for each kind of evidence. (6)
- 3.3 The following data was gathered during one of the recent audits of the Accounts Receivables (Debtors) section. One of the findings was on the material increase in bad debts expenses. In preparing a report of the findings, each of the items might be classified as criteria, cause, condition and effect. Examine the following items and identify each item as the Criteria, Condition, Cause or Effect. Give reasons for your answer.
- a Audit tests showed that only some of the new accounts received, were reviewed
  - b The bad debts loss increased by R 78 000 during the last financial year
  - c Credit department policy requires the review of credit references for all new accounts
  - d According to the new credit manager, strict adherence to established credit policy is not necessary
- (4)

(Wiley CIA Review, adapted )

**[TURN OVER]**

**3 4** Match column A (term) with its corresponding meaning in column B  
Your answer should look as follows 3 4 1 d **(6)**

|              | <b>Column A</b>           | <b>Column B</b>  |
|--------------|---------------------------|--|
| <b>3.4 1</b> | Accurate information is   | <b>a.</b> supports engagement observations and recommendations and is consistent with the objectives for the engagement  |
| <b>3.4 2</b> | Sufficient information is | <b>b.</b> fair, impartial, and unbiased and presents the result of a fair-minded and balanced assessment of all relevant facts and circumstances                                   |
| <b>3 4 3</b> | Concise information is    | <b>c.</b> free from errors and distortions and faithful to the underlying facts  |
| <b>3 4.4</b> | Complete information      | <b>d</b> to the point and avoids unnecessary elaboration, superfluous detail, redundancy and wordiness   |
| <b>3.4.5</b> | Relevant information      | <b>e.</b> the best attainable information through the use of appropriate engagement techniques   |
| <b>3.4 6</b> | Objective information is  | <b>f.</b> helps the organisation meet its goals  |
|              |                           | <b>g.</b> factual, adequate and convincing so that a prudent person would reach the same conclusion as the auditor   |
|              |                           | <b>h.</b> lacks nothing that is essential to the target audience and includes all significant and relevant information and observations to support recommendations and conclusions |

**QUESTION 4**

**15 marks**

The International Professional Practices Framework (IPPF) contains three mandatory elements, namely (a) the Definition of Internal Auditing, (b) the Code of Ethics, and (c) the International Standards for the Professional Practice of Internal Auditing (Standards)

**REQUIRED**

**Marks**

With reference to the Institute of Internal Auditors (IIA) Code of Ethics, conclude and explain, whether each of the scenarios below is permissible or not. Please provide reasons for each of your conclusions

**[TURN OVER]**



- 4.1 To save organisational costs, the chief audit executive has cancelled all staff training for the next two years on the basis that all internal audit staff is too new to benefit from such training (3)
- 4.2 An internal auditing team has made observations and recommendations that should significantly improve a department's operating efficiency. As a token of appreciation, the department manager presents James, the internal audit manager with a gift of moderate value. Since it shows appreciation for the work and because it is the holiday season, James accepts the gift (3)
- 4.3 Simon, an internal auditor has been assigned to audit the human resources department which is managed by his wife (3)
- 4.4 Matthew, an internal auditor for a manufacturer of office products, has recently completed an engagement to evaluate the marketing function. Based on this experience, Matthew spends several hours one Saturday working as a paid consultant to a local hospital that intends conducting an engagement to evaluate its marketing function (3)
- 4.5 An internal auditor did not report significant findings about illegal activity to the audit committee because management had indicated they would handle the issue (3)

(Gleim and Wiley CIA Review adapted)

**QUESTION 5**

**37 marks**

You have recently been appointed as the chief audit executive (CAE) of a newly formed internal audit division at Data Magic (Pty) Limited. The company specialises in software training and has grown substantially over the last five years. The managing director, who appointed you, believes that your appointment and the establishment of an internal audit department would assist her to better improve control in this fast growing company.

After your first few weeks, the internal audit department is slowly shaping up. You are planning to present a workshop for all the departments of the organisation, to present the internal audit department and its workings.

**REQUIRED**

**Marks**

In your presentation, discuss the following topics

- 5.1 Describe ~~ten~~ (10) advantages of having an internal audit function in the organisation (10)

**[TURN OVER]**

- 5.2** An internal auditor is also an adviser in the organisation. Give **seven (7)** examples of how internal audit can assist management (7)
- 5.3** Explain the aspects that should be included in the internal audit charter that grant internal audit the necessary authority (5)
- 5.4** List **five (5)** responsibilities of the internal audit activity as per the internal audit charter (5)
- 5.5** List **five (5)** practices that would enhance a good relationship between the audit committee and the internal audit activity (5)
- 5.6** Mention **five (5)** actions which can contribute to good co-operation and co-ordination between the internal and external auditors (5)