



Tutorial Letter 202/1/2018

INTERNAL AUDIT PROCESS: SPECIFIC ENGAGEMENTS AND REPORTING

AUI3703


SEMESTER 1

Department of Auditing

IMPORTANT INFORMATION

This tutorial letter contains important information about your module.

BAR CODE



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1 BRIEFING

This tutorial letter contains the solutions to Assignment 01 for this semester. The lecturer has marked a selection of the questions in this assignment. The marks you received for your answers to these questions will constitute your mark for this assignment and will contribute towards your year mark. You need to assess your answers to the other questions yourself by comparing your answers to those provided in this tutorial letter.

Use the marking plan as a guide to award yourself marks for your answers. Take care not to mark the same concept more than once just because it appears more than once, perhaps in different words or in a different format.

After you have marked your own answers, please reflect carefully on your result to determine why you could not allocate full marks to your answers. Please ensure that you allocate marks only to valid answers. It is imperative that you identify your problem areas now, while you can still do something about them. If you do not solve all your problems as soon as you have identified them, you may repeat the same mistakes in the examination, and that could prove very costly. Marking your answers should enable you to identify any problems you may be experiencing. Your marks for this assignment will be an indication of your level of knowledge of the module content at this stage. You should still have enough time left to revise the work and solve the identified problem areas before the examination.

We trust that you have found the assignment both interesting and informative and that it has served as an aid for your examination preparation. Should you encounter any difficulties regarding this module in internal auditing, please do not hesitate to contact us.

Lecturer

AUI3703

2 KEY TO ASSIGNMENT 02/2018 (1ST SEMESTER)

QUESTION 1

24 marks

Continuity of operations – risk assessment

1. It appears that the company has no formal risk assessment component as part of its internal control process.
2. IT risk is a recognised risk faced by all businesses which rely on IT to function effectively and it is essential that
 - 2.1 IT risk is continually assessed by
 - 2.2 individuals who have an appropriate level of experience and understanding of the IT risks faced by a company such as Pump Champ (Pty) Ltd.
3. The directors have no interest in this important control requirement and Jill Clinton, to whom the technicians report, is by her own admission “not strong on computer technology” and therefore is hardly likely to understand IT risk.
4. This lack of formal risk assessment results in inadequate response to IT risk, leaving Pump Champ (Pty) Ltd open to
 - 4.1 fraud and theft perpetrated through the IT system
 - 4.2 physical and infrastructural damage
 - 4.3 confidentiality issues/abuse
 - 4.4 data loss or destruction
 - 4.5 non-compliance with IT laws, rules and standardsall of which singularly or collectively can threaten the company’s continuity of operations.

Continuity of operations – physical security

1. It appears that there is inadequate security surrounding the system equipment (servers etc.). These are located in a general office in the accounting section.
2. Whilst the company is probably not large enough to warrant sophisticated physical security measures, the equipment (obviously other than user terminals) should be housed in its own secure room which is access controlled by say, keypad and code with access restricted to IT personnel. Leaving this integral part of the system in a general office lays the system open to abuse.

Control environment – organisational structure

1. Essentially there is no organisational structure either within the “IT section” itself, or as regards the IT section and the company itself.
2. There is no assignment of authority and responsibility within the section, as the three technicians “run the entire show” as they deem fit.
3. Nominally they report to Jill Clinton but this is meaningless as she provides no leadership and does not interact much with them.
4. There is no segregation of duties within the IT section with the result that the three technicians perform incompatible functions. They are all on the same level so again lines of reporting and delegation of authority are not functional.

Control environment – commitment to competence, participation by those charged with governance and management’s philosophy and operating style

1. As it stands, there is nobody in the company to which the “IT section” can report for guidance and leadership. The directors do not have the knowledge or the interest and the financial manager (who should be extremely concerned) simply chooses not to interact with the three technicians.
2. This shows a distinct lack of commitment to competence and a management style which could lead to a total lack of control consciousness. The three technicians will be fully aware that there is no control over them and that they can do whatever they like!
3. This complete lack of understanding of the risks associated with IT, implies that it is very unlikely that there will be any ethical guidance/code of conduct given to the “IT section”, or that proper human resource policies and practices as they relate to IT personnel, are in place.
4. The IT section will have to be restructured and a suitable IT manager appointed if these risks are going to be addressed.

Systems development and programme change controls

1. Programme changes should not be made by the technicians “as they see fit” but rather as a result of properly motivated requests from users.
2. As the organisational structures and reporting lines relating to the interface between the “IT section” and the users is blurred, it seems very unlikely that proper programme controls can be implemented, e.g. there is no IT manager or steering committee to evaluate and approve the change.
3. There is also no way of preventing the three technicians from making programme changes if they want to. These changes may be detrimental to the company.
4. The same argument applies to the decision of one of the technicians (obviously supported by the other two) to write and implement application software for the issuing of passwords. Clearly this software is poorly designed (see access control) so could not have been subjected to the very important control procedures to which any new application software should be subjected. The company simply does not have the necessary structures or competencies to write and implement such applications.

Access controls

1. Besides the lack of physical access controls to the IT equipment mentioned earlier, the logical access controls at Pump Champ (Pty) Ltd are very poor.
2. Only those employees who need access to the computer to fulfil their functions, should be given access – to give factory personnel access privileges so that they can send emails and browse the internet during their breaks, is an extremely unwise and unnecessary policy which can lead to serious abuse of the system. Access should be given on a “least privilege/need to know” basis.
3. The application software written for the allocation of passwords is unnecessary as the systems software would include programmes for “registering”, changing, storing and deleting passwords. Again the total lack of management of the company’s IT employees has facilitated this situation.
4. In terms of this application
 - 4.1 passwords do not conform to the recommended format for passwords (six characters with a mix of numerical, alphabetic and symbol digits)

- 4.2 passwords are not unique to the user and are not confidential (they will be known or obtainable by at least the three technicians)
 - 4.3 passwords of employees who have left the company are only invalidated every six months, not immediately the employee resigns or is dismissed.
5. The fact that the three technicians all have access/super user access, combined with the fact that they are totally unsupervised, is a tremendous risk to the company.

(1 mark for the listing of each general control and 1 mark for each valid weakness, to a maximum of 24 marks)

QUESTION 2

18 marks

Reference: Study guide, section 7.1

2.1

- A. Cause
- B. Effect
- C. Standard
- D. Condition / Description
- E. Recommendation
- F. Recommendation

(1 mark for each correct match. Max.6)

2.2 Give the definitions of Efficiency, Effectiveness and Economy. 6 marks

Study Unit 7 pg 42

Effectiveness - the extent to which an activity achieves its stated performance objectives
(2)

Economy - the extent to which an activity gets the right quantity and quality of resource at the right time and best possible price. **(2)**

Efficiency - The extent to which an activity has been optimised such that, all other things remaining constant,

- Output is maximised for a given amount of input; or
- Input has been minimised for a given amount of output **(2)**

(2 marks for each definition. Max.6)

2.3 Formulate four (4) audit procedures that could be used to provide assurance regarding the efficiency of the processes at Dem Bones. 6 marks

- Discuss with the staff at each of the locations the cause of delays.
- Inspect records and summarise the number of patients seen per day.
- Calculate the average length of a consultation.

- Discuss with management the optimal number of patients that should be seen taking into account other factors such as maintenance.
- Benchmark the length of consultations/number of patients seen or any other efficiency ratio internally between branches as well as to other similar practices or industry standards.

(1½ marks for each procedure. Max.6)

QUESTION 3

19 marks

3.1 Differentiate between assurance and consulting engagements and list whether it will form part of an assurance or consulting engagement.

Reference: Study guide, section 6.1

Assurance services – An objective examination of evidence for the purpose of providing an independent assessment on governance, risk management and control processes for the organisation. (1½)

Consulting services – Advisory and related client service activities, the nature and scope of which are agreed with the client, are intended to add value and improve an organisation's governance, risk management and control processes without the internal auditor assuming management responsibility. (1½)

- 1- Consulting service (1)
- 2- Advisory service (1)
- 3- Consulting service (1)

(Marks as indicated. Maximum of 6 marks.)

3.2 CAATS should be correctly applied during the audit process. Describe the audit functions that CAATS can best be used for during the audit process.

Reference: Study guide, section 5.4

- Sorting and file reorganisation. Data can be sorted by date, customer name, department name etc. (1)
- Summarisation, stratification and frequency analysis. Data can be

summarised in account number order and the frequency with which certain items are bought. (1)

- Extracting samples, exception reporting, file comparison etc.(1)
- Analytical review, for example extraction of ratios.(1)
- Casting and recalculation. (1)
- Examining records for inconsistencies, inaccuracies and missing data and creating reports. (1)

(Marks as indicated. Maximum of 6 marks)

3.3 For each of the controls listed in 1 to 7 indicate whether they are general controls or application controls.

Reference: Study guide, section 5.3

1. General control
2. General control
3. General control
4. Application control
5. General control
6. Application control
7. Application control

(One mark for each control correctly identified. Maximum 7 marks)

QUESTION 4

11 marks

- 4.1** Standard 1200 – Proficiency and Due Professional Care applies here **(1/2)** 2300 Performing the Engagement **(1/2)** Code of Ethics – Competency **(1/2)**. The IIA Standards apply in all situations that the internal auditor works in, not just “official activities” like a planned audit. **(1)** Signing off a statement is considered an “audit activity” and assumes that the report is based on facts that have been checked. **(1)** Standard 2320 requires that internal auditors must “identify, analyse, evaluate and document sufficient information to achieve the engagement’s objectives. **(1)** Just checking the adding of the list of expenses is not sufficient in the current example. **(1)** Also the composition of the list should be considered? Is everything on the list that should be there; or is there anything on the list that should not be there? **(1)**.

Marks as shown. Max 5 marks

- 4.2** Code of Ethics – Confidentiality (1/2) in the rule of conduct specifically states that an internal auditor “Shall not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the organization.” (½ - **okay if not exactly quoted**) Precious used the non-public information that she gained in the course of her work in order to make a profit. (1) That this was to go to a “good cause” doesn’t mitigate the contravention of the code. (1)

Marks as shown. Max 3 marks

- 4.3** IPPF: Code of Ethics – Confidentiality (½); Standard 1220 Due Professional Care (½). As an internal auditor we are required to gain access to confidential information in order to do our work. In order to earn the right to the access of confidential information internal auditors need to treat that information in such a way as to ensure its safe keeping. (1) It can be argued that in the South African context leaving a laptop in the boot of a locked car that is parked on the street overnight is a contravention of the Standard Due Professional Care because of the likelihood that the car will be broken into and the laptop stolen. (1) In addition internal auditors should ensure that the data that they have is adequately secured through the use of passwords and other tools to provide additional security in the event that the device containing the data is lost. (1)

Or other relevant points. Max 3 marks.

QUESTION 5

29 marks

- 5.1 Formulate six (6) audit objectives that could be used to provide assurance with regards to the efficiency of the installation’s department.**

References: Study guide, section 3.2.3

- To determine whether the installations department is divided into logically manageable tasks.
- To determine whether the installations department is structured in such a way as to improve the manageability of the installation processes.
- To determine that all staff are utilised within the department.
- To determine whether there are any vacancies and when they will be filled.
- To determine whether the staff is satisfied with their workload or if they have received any complaints regarding this issue recently.

- To determine that the documentation flow is efficient.
- To determine that no unnecessary tasks are performed and that no tasks are duplicated.
- To determine the allocation of responsibilities and authority within the installations department is efficient.

(1½ mark for each valid audit procedure. Maximum of 9 marks.)

5.2 For each of the statements indicate whether it relates to effectiveness, efficiency or economy and formulate an audit procedure.

References: Study guide, section 3.2

Number	Efficiency, economy, effectiveness	Audit procedure
i	Efficiency (1)	Through observation of the allocation process ensures that all tasks are allocated fairly between the technicians and that there is no idle time; ensure that all tasks are completed in time. (1½)
ii	Efficiency (1)	Trace the various documents through the various departments and determine whether the document flow is efficient.(1½)
iii	Efficiency (1)	Enquire from management why the positions are vacant and when they will be filled. (1½)
iv	Effectiveness (1)	Evaluate the organisation's approach to the development of realistic targets and objectives. (1½)
v	Economy (1)	Enquire from management why there surplus stock is on hand and determine how the economic order quantity is calculated. (1½)
vi	Economy (1)	Request the purchasing policy from management and ensure that the department adheres to the policy. (1½)
vii	Efficiency (1)	Calculate the time from when the working order has been created to completion of the installation and ensure that the 24 hour turnaround time has been met. (1½)
viii	Effectiveness (1)	Evaluate the adequacy of management's method of measuring effectiveness (1½)

(Marks as indicated. Maximum 20 marks.)

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