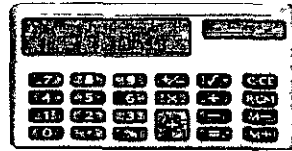


UNIVERSITY EXAMINATIONS



UNIVERSITEITSEKSAMENS

UNISA 
university
of south africa

AUI3704

October/November 2016

MANAGING THE INTERNAL AUDIT ACTIVITY

Duration 2 Hours

100 Marks

EXAMINERS

FIRST

SECOND

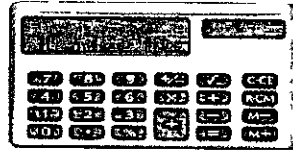
MRS BM VAN WYK

MS M EDWARDS

Use of a non-programmable pocket calculator is permissible

Closed book examination.

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THIS PAPER CONSISTS OF **THIRTEEN (13)** PAGES

QUESTION	MAIN TOPIC	MARKS
1	Multiple-choice questions	30
2	Internal Audit Charter	30
3	Responsibilities of Internal Audit Activity	25
4	International Professional Practice Framework (IPPF)	<u>15</u>
		<u>100</u>

PLEASE NOTE:

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

[TURN OVER]

QUESTION 1

30 marks

REQUIRED

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

1.1 A

1.2 B

Each question counts 1½ marks

- 1.1 An internal auditor often faces special problems when performing an engagement at a foreign subsidiary. Which one of the following statements is **false** with respect to the conduct of international engagements?
- A It is preferable to have multilingual internal auditors conduct engagements at branches in foreign nations
 - B The internal auditor should determine whether managers are in compliance with local laws
 - C The *IIA Standards* do not apply outside of the United States of America
 - D There may be justification for having different organisational policies in force in foreign branches
- 1.2 When evaluating the independence of an internal audit activity, a quality assurance review team performing an external assessment considers several factors. Which of the following factors has the **least** amount of influence when judging an internal audit activity's independence?
- A Criteria used in making internal auditors' assignments
 - B The extent of internal auditor training in communications skills
 - C Relationship between engagement records and engagement communications
 - D Impartial and unbiased judgments

- 1.3 An internal auditor most likely will have a conflict of interest by providing an assurance service with regard to a
- A financial activity in which the internal auditor had been a key employee five years previously
 - B purchasing activity if a major supplier is owned by the internal auditor's sister-in-law
 - C data processing centre for which the internal auditor had performed the services three times previously
 - D computer system for which the internal auditor had been the internal audit activity's representative on the design team
- 1.4 Management has requested the internal audit activity to perform an engagement to recommend procedures and policies for improving management control over the telephone marketing operations of a major division. The chief audit executive should
- A not accept the engagement because recommending controls would impair future objectivity regarding this operation
 - B not accept the engagement because internal audit activities are presumed to have expertise regarding accounting controls, not marketing controls
 - C accept the engagement, but indicate to management that, because recommending controls impairs independence, future engagements in the area will be impaired
 - D accept the engagement because objectivity will not be impaired
- 1.5 Reengineering is the thorough analysis, fundamental rethinking, and complete redesign of essential business processes. The intended result is a dramatic improvement in service, quality, speed, and cost. An internal auditor's involvement in reengineering should include all of the following **except** ...
- A determining whether the process has senior management's support
 - B recommending areas for consideration
 - C developing audit plans for the new system
 - D directing the implementation of the redesigned process

- 1.6 Assuming that an internal audit staff member possesses the necessary experience and training, which of the following services is most appropriate for this internal auditor to undertake?
- A Substitute for the accounts payable supervisor while (s)he is on sick leave
 - B Determine the profitability of alternative investment acquisitions and select the best alternative
 - C As part of an evaluation team, review vendor accounting software internal controls and rank according to exposures
 - D Participate in an internal audit of the accounting department shortly after transferring from the accounting department
- 1.7 An internal auditor observes that a receivables clerk has physical access to and control of cash receipts. The auditor worked with the clerk several years before and has a high level of trust in the individual. Accordingly, the auditor notes in the engagement working papers that controls over receipts are adequate. Has the auditor exercised due professional care?
- A Yes, reasonable care has been taken
 - B No, irregularities were not noted
 - C No, alertness to conditions most likely indicative of irregularities was not shown
 - D Yes, the engagement working papers were annotated
- 1.8 External assessment of an internal audit activity is **not** likely to evaluate
- A adherence to the internal audit activity's charter
 - B conformance with the IIA Standards
 - C detailed cost-benefit analysis of the internal audit activity
 - D the tools and techniques employed by the internal audit activity

- 1.9** The IIA Rules of Conduct set forth in the IIA Code of Ethics
- A describe behaviour norms expected of internal auditors
 - B are guidelines to assist internal auditors in dealing with engagement clients
 - C are interpreted by the Principles
 - D apply only to particular conduct specifically mentioned
- 1.10** The internal auditor is considering making a risk analysis as a basis for determining the areas of the organisation where engagements should be performed Which one of the following statements is true regarding risk analysis?
- A The extent to which management judgments are required in an area could serve as a risk factor in assisting the internal auditor in making a comparative risk analysis
 - B The highest risk assessment should always be assigned to the area with the largest potential loss
 - C The highest risk assessment should always be assigned to the area with the highest probability of occurrence
 - D Risk analysis must be reduced to quantitative terms in order to provide meaningful comparisons across an organisation
- 1.11** Which of the following adds value to the others?
- A Governance processes
 - B Risk management processes
 - C Internal audit activities
 - D Control processes

- 1.12** All of the following are examples of consulting services **except**
- A legal counsel engagement
 - B system security engagement
 - C advice engagement
 - D facilitation engagement
- 1.13** An internal auditor is auditing the financial operations of an organisation. Which of the following is **not** specified by the IIA Standards for inclusion in the scope of the audit?
- A Reviewing the reliability and integrity of financial and operational information
 - B Reviewing the compliance with laws, regulations, policies, procedures and contracts.
 - C Appraising the effectiveness and efficiency of operations and programmes
 - D Reviewing the financial decision-making process
- 1.14** In which of the following situations does the auditor potentially lack objectivity?
- A An auditor reviews the procedures for a new electronic data interchange connection to a major customer before it is implemented
 - B A former purchasing assistant performs a review of internal controls over purchasing four months after being transferred to the internal auditing department
 - C An auditor recommends standards of control and performance measures for a contract with a service organisation for the processing of payroll and employee benefits
 - D A payroll accounting employee assists an auditor in verifying the physical inventory of small motors

- 1.15** To be successful, large companies must develop means to keep the organisation focused in the proper direction. Organisation control systems help keep companies focused. These control systems consist of which of the following components?
- A Budgeting, financial ratio analysis and cash management
 - B Objectives, standards and an evaluation-reward system
 - C Role analysis, team building and survey feedback
 - D Coaching, protection and challenging assignments
- 1.16** The status of the internal auditing activity should be free from the impact of *irresponsible policy changes* by management. The most effective way to ensure that freedom is to
- A have the internal auditing charter approved by both management and the board of directors
 - B adopt policies for the functioning of the internal audit activity
 - C establish an audit committee within the board of directors
 - D develop written policies and procedures to serve as standards of performance for the department
- 1.17** In an organisation that has a separate division that is primarily responsible for fraud deterrence, the internal audit activity is responsible for
- A examining and evaluating the adequacy and effectiveness of that division's actions *take to deter fraud*
 - B establishing and maintaining that division's system of internal controls
 - C planning that division's fraud deterrence activities
 - D controlling that division's fraud deterrence activities

- 1.18** Which of the following facilitates and reduces the cost of the external assessment of an internal audit activity?
- A A periodic internal assessment performed within a short time before an external assessment
 - B A periodic internal assessment performed in parallel with an external assessment
 - C A periodic internal assessment performed within a long time before an external assessment
 - D A periodic internal assessment performed within a short time after an external assessment
- 1.19** Which of the following can be used by an independent external reviewer when establishing the scope of the external assessment of an internal audit activity?
- A Percentage of audit plan completed in a year by the internal audit activity
 - B Number of findings reported in a year by the internal audit activity
 - C Percentage of quality assurance and improvement programmes implemented by the internal audit activity
 - D Number of audit recommendations accepted in a year by the auditees
- 1.20** When reviewing audit working papers, the **primary** responsibility of an audit supervisor is to determine that
- A each worksheet is properly identified with a descriptive heading
 - B working papers are properly referenced and kept in logical groupings
 - C standard departmental procedures are adhered to with regard to working paper preparation and technique
 - D working papers adequately support the audit findings, conclusions and reports

QUESTION 2

30 marks

You are the newly appointed chief audit executive (CAE) at A-Smile-a-day Ltd. The board of directors was of the opinion that the introduction of an internal audit activity is vital for the success of their organisation.

In the subsequent months, an in-house internal audit activity is established. As one of your priorities, you have compiled the following internal audit charter.

**Charter
Internal Auditing Department**

1. Introduction

Internal Auditing is an independent and objective assurance and consulting activity designed to add value and improve A-Smile-a-day Ltd's operations.

2. Role

The internal auditing department is established by management, and its responsibilities are defined by the audit committee of the board of directors as part of its oversight function.

3. Professional Standards

The internal auditing staff should perform their work professionally according to the universal auditing standards.

4. Authority

Authority to access documents must be obtained at all times before an engagement is started, and no communication may take place without the Chief Executive Officer's (CEO) specific agreement.

Documents and information given to Internal Auditing during a periodic review will be handled in the same prudent and confidential manner as those employees who are normally accountable for them would.

5. Organisation

The Chief Audit Executive (CAE) shall report to the CFO, both functionally and administratively.

6. Independence

All internal audit activities shall remain free of influence by any element in the

organisation, including matters of audit selection, scope, procedures, frequency, timing, or report content to permit maintenance of an independent and objective mental attitude necessary in rendering reports

Internal Auditors can be asked to assist with specific operational responsibilities when necessary.

7. Audit scope

The scope of internal auditing encompasses the examination and evaluation of any activity directed by the CEO when he/she regards such an activity due for an investigation

8. Audit planning

Annually, the CAE shall submit to senior management and the audit committee a summary of the audit work schedule, staffing plan, and budget for the following fiscal year. This will only be for information purposes and not for approval

9. Reporting

The CAE or designee will prepare and issue a written report following the conclusion of each audit and this will be distributed to the CEO only

Internal Auditing shall be responsible for appropriate follow-up on audit findings and recommendations when instructed by the Chief Financial Officer (CFO), after discussion with the CEO

10 Periodic assessment

The Chief Audit Executive should periodically assess whether the purpose, authority and responsibility, as defined in this charter, continue to be adequate to enable the internal auditing activity to accomplish its objectives. The result of this periodic assessment should be communicated to senior management

11. Approval

Signed CAE _____ CEO _____

REQUIRED	Marks
2.1 Indicate whether the charter complies with the Standards and definition of internal auditing	(5)
2.2 Where necessary, (that is, where no or partial compliance is indicated), recommend how the wording should be changed to bring the existing charter in line with the Standards and the definition of internal auditing	(25)

Structure your answer in the following format

Aspect	2.1 Comply (Yes/No/Partially)	2.2 Changes recommended
1	(½)	(1 mark per valid recommendation)

QUESTION 3

25 marks

Do-Something Ltd, a large manufacturing company, has recently established an internal audit activity (department) The company has a properly constituted audit committee in place As often happens when departments are established, there is some confusion as to exactly what the department should and should not be doing Alfred Mda, the financial director is preparing for a meeting with the chief audit executive (CAE) and not being particularly familiar with the role of internal audit, has asked you to provide him with a general overview of what internal audit are about and whether the following procedures/responsibilities should be undertaken by the internal audit activity

- 1 Performing the monthly bank reconciliations on the company's bank account
- 2 Conducting surprise cash counts at the company's various manufacturing facilities A material amount of cash is frequently on hand as metal off-cuts are sold to scrap dealers on a cash only basis
- 3 Performing inventory cycle counts every month as part of the company's internal control over their perpetual inventory
- 4 Investigating suspected instances of fraud within the company
- 5 Searching for (head hunting) suitable financial staff
- 6 Conducting a review of the extent to which the marketing department complies with the practices and procedures laid down by the company
- 7 On a regular basis, to analyse and follow-up on calls from suppliers as to the conduct of the company's buying/purchasing personnel registered on the

company's "telephone complaints hotline "

- 8 Reviewing the **draft** integrated report (which includes, inter alia, the financial statements) before it is given to the external audit team

REQUIRED

Marks

- 3.1 Provide Alfred Mda with an overview of the roles of an internal audit activity to the extent that he will have a better understanding of what he is likely to be told by the chief audit executive (5)
- 3.2 Indicate to Alfred Mda (giving brief reasons) whether the internal audit department should undertake the procedures/responsibilities listed above (20)

QUESTION 4

15 marks

Consider the following unrelated situations

- 1 A new internal auditor was told to perform an engagement in an area with which the internal auditor was not familiar. Because of time constraints, no supervision was provided. Although the assignment provided a learning experience to the new internal auditor, it was beyond the internal auditor's competence level. In spite of the challenges, the internal auditor prepared comprehensive working papers and communicated the results to management. Which IIA Standard was violated by the internal audit activity and why?
- 2 A Certified Internal Auditor (CIA) was appointed as the director of purchasing and is not involved in the internal audit activity of the organisation at all. The CIA was involved in the tender process of a large contract to procure directly from a sole supplier at the best price, quality and performance. Shortly after the tender was awarded and the contract was signed, the chosen supplier presented the CIA with a gift of significant monetary value. By accepting the gift, did the CIA violate the IIA Code of Ethics and why?
- 3 While auditing the research and development department, the internal auditor learnt that a new product is being launched soon. According to the product manager, this product will have a revolutionary impact on the market and is very likely to be successful. The internal auditor used this

information to buy more shares in the company to benefit from future profits as a result of the new product. By using this information on a personal level, did the internal auditor violate the IIA Code of Ethics and why?

- 4 Alice Mkhize, the Chief Audit Executive of Velocity Engineers (Pty) Ltd, refused to provide an internal audit report to the investigating officer of the South African Police Services (SAPS), even though Alice has received a court order informing her to disclose the report to the SAPS. The court believes that the internal audit report will assist the SAPS in its investigation against the financial director at Velocity Engineers (Pty) Ltd.
- 5 As an internal auditor at a chemical manufacturer you became aware of the fact that toxic waste has been dumped illegally at a general dumping site. You decided out of loyalty to the company not to do any further investigation and not to report the illegal dumping of the toxic waste. Are you violating the Code of Ethics and why?

REQUIRED

For each of the scenarios above, indicate the principle in the code of ethics or IIA Standards that has been violated. Support your answer by explaining the violation and briefly describe the appropriate conduct that should have been followed by the internal auditor or the internal audit activity. **(15)**

Structure your answer as follows

Principle violated	Explanation of the violation	Appropriate conduct
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