


**AUI2016
AUI2601**

May/June 2012

INTRODUCTION TO INTERNAL AUDITING

Duration 2 Hours

100 Marks

EXAMINERS :

Use of a non-programmable pocket calculator is permissible

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THIS PAPER CONSISTS OF **EIGHT(8)** PAGES

QUESTION	MAIN TOPIC	MARKS
1	Multiple-choice questions	18
2	Part A: Internal audit definition	25
	Part B: Code of ethics	15
	Part C: Internal audit process	20
3	Fraud and fraud risk	<u>22</u>
		<u>100</u>

NOTE

Although the primary purpose of the examination is to test your knowledge and application of the subject matter, the examiners will take into consideration your ability to organise, apply and present this knowledge in written language of an acceptable standard

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QUESTION 1

18 marks

REQUIRED

For each subquestion of this question, select only **one** alternative that you consider the most correct answer. In your answer book, write down the number of the subquestion, and next to it the letter representing the alternative you have selected. Answer the subquestions in numerical sequence, for example:

1.1 A

1.2 C

Each question is worth 1½ marks

- 1.1 According to the IIA Standards, internal auditors must be objective in performing internal audits. Assume that the chief audit executive (CAE) received an annual bonus as part of his/her compensation package. The bonus may impair the CAE's objectivity if?
- A The bonus is administered by the board of directors or the remuneration committee
 - B The bonus is based on recommended future savings as a result of internal audits
 - C The scope of internal audit work is reviewing control rather than account balances
 - D All of the answers are correct
- 1.2 Management has requested the internal audit function to perform an operational audit of the telephone marketing operations of a major division and to recommend procedures and policies for improving management control over the operation. The internal auditor should?
- A Not accept the engagement because recommending controls would impair future objectivity in respect of the auditee
 - B Not accept the engagement because internal audit functions are presumed to have expertise on accounting controls and not marketing controls
 - C Accept the engagement but indicate to management that because recommending control impairs internal audit independence, future internal audits of this department will be impaired
 - D Accept the internal audit engagement because independence will not be impaired

- 1.3** Follow-up activity is required to ensure that corrective action has taken place. The internal audit function's responsibility to perform follow-up activities as required should be defined in the?
- A Internal audit function's written charter
 - B Mission statement of the audit committee
 - C Engagement memorandum issued prior to each internal audit assignment
 - D Purpose statement within the applicable internal audit reports
- 1.4** Which one of the following represents appropriate internal audit action in response to the risk assessment process?
- I The low risk areas may be delegated to the external auditor, but the high risk areas should be audited by the internal audit function
 - II. The high risk areas should be integrated into an internal audit plan along with the high priority requests of management and the audit committee
 - III. The risk analysis should be used in determining an annual internal audit work plan; therefore the risk analysis should be performed only on an annual basis
- A I only
 - B III only
 - C II only
 - D I and III only
- 1.5** An internal auditor fails to discover an employee fraud during an internal audit. The non-discovery is most likely to suggest a violation of the IIA Standards if it was the result of a
- A Failure to perform a detailed internal audit of all transactions in the area
 - B Determination that any possible fraud in the area would not involve a material amount
 - C Determination that the cost of extending internal audit procedures in the area would exceed the potential benefits
 - D Presumption that the internal controls in the area were adequate and effective

- 1.6 During the course of an internal audit, an internal auditor discovers that a clerk is defrauding the company. Although this is the first fraud ever encountered at the organisation and the organisation has a security department, the internal auditor decides to personally interrogate the suspect. If the internal auditor is violating the *Code of Ethics*, the rule violated is most likely?
- A Failing to show due diligence
 - B No violation of the Code of Ethics has occurred
 - C Lack of competence in the area of fraud examination
 - D Failing to comply with the law
- 1.7 During an internal audit, an employee with whom you have developed a good working relationship informs you that she has some information about top management that would be damaging to the organisation and may concern illegal activities. The employee does not want her name associated with the release of the information. Which one of the following actions would be a violation of the IIA Code of Ethics and Standards?
- A Assure the employee that you can maintain her anonymity and listen to the information
 - B Suggest the employee consider talking to legal counsel
 - C Inform the employee that you will attempt to keep the source of the information confidential and will look into the matter further
 - D Inform the employee of other methods of communicating this type of information
- 1.8 An internal audit programme for a comprehensive internal audit of a purchasing function should include?
- A Work steps arranged by each steps' priority based upon the perceived risk
 - B A statement of the audit objectives of the purchasing function
 - C Specific methods to accomplish the internal audit objectives
 - D A focus on risks affecting the financial statements.

- 1.9** Which one of the following activities performed by a payroll clerk is a control weakness rather than a control strength?
- A Has custody of the cheque signature stamp machine.
 - B Prepares the payroll register
 - C Forwards the payroll register to the chief accountant for approval.
 - D Draws the paycheque on a separate payroll cheque account
- 1.10** An adequate system of internal control is most likely to detect an irregularity perpetrated by a
- A Group of employees in collusion
 - B Single employee
 - C Group of managers in collusion
 - D Single manager
- 1.11** The IIA Standards define competent information as
- A Supporting the internal audit findings and being consistent with the internal audit objectives
 - B Assisting the organisation in meeting prescribed goals
 - C Factual, adequate and convincing so that a prudent person would reach the same conclusion as the internal auditor
 - D Reliable and the best available through the use of appropriate engagement techniques
- 1.12** When reviewing internal audit working papers, the primary responsibility of an internal 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 internal audit findings, conclusions and reports

[TURN OVER]

QUESTION 2

60 marks

You are a trainee internal auditor employed at the Department of Education (DoE) in Pretoria. You are also currently registered as a BCom Internal Auditing student with Unisa.

PART A

25 marks

The Minister of Basic Education decided to implement an awareness programme focused on introducing different professions to Grade 10 learners. The focus of the initiative is to make learners aware of the different options available to them after completion of their secondary education. All the different divisions in the DoE were requested to make presentations on their field of expertise. The internal audit department chose you to make a presentation, introducing internal auditing to a local secondary school.

REQUIRED

Marks

- 2.1 Describe the **objective, boundaries and methodology** of the internal audit activity as contained in the definition of internal auditing (6)
- 2.2 Indicate what an effective internal audit activity should contribute to both the company and the board (4)
- 2.3 List **ten (12)** personal characteristics an internal auditor should have in order to carry out his/her task efficiently and professionally (6)
- 2.4 Describe the nature of the work that the internal audit activity is required to perform to improve the **risk management** and **governance** processes of an organisation or the DoE by referring to the Standards (9)

PART B

15 marks

You have been assigned to an internal audit of the payroll function. The DoE pays weekly wages to maintenance, cleaning and gardening staff. All other personnel are paid monthly via electronic fund transfers (EFTs) into their bank accounts.

The following colleagues have also been assigned to the payroll audit:

- I Ms Z, the internal audit senior on the assignment, is married to the payroll manager, Mr X. She kept her maiden surname as she does not want anybody to know that she is married to Mr X.
- II Ms Knowledge, the internal auditor on the assignment, used to work at the payroll department. She was appointed as an internal auditor the previous month owing to a shortage of staff in the internal audit department.

[TURN OVER]

REQUIRED

Marks

- 2.5** Consider each of the above scenarios in view of the Institute of Internal Auditors'(IIA's) code of ethics. Indicate whether or not each of the scenarios is contravening the code of ethics and if so, indicate the principle(s) involved, the rules of conduct and give reasons for your answer **(10)**

Use the following format to answer the question

Question No.	Yes/No	Principle	Rules of conduct	Reason
(I)	(½)	(1)	(2)	(2)
(II)	(½)	(2)	(3)	(2)

- 2.6** Describe the liability which an internal auditor can incur towards his/her employer **(5)**

PART C

20 marks

You have been assigned to conduct a review of wage payments. The following internal controls have been identified.

- I All overtime worked is authorised by the section head
- II The payroll administrator checks the payroll for arithmetic accuracy
- III The payroll manager matches the wages cheque amount to the amount of total net wages for the same period
- IV Employees are required to sign for their wages

REQUIRED

Marks

- 2.7** List, in sequence, the **four (4)** main phases or steps of the internal audit process and then briefly describe each phase or step **(8)**
- 2.8** Give **one (1)** example of what can go wrong because of the absence of each of the controls listed in the scenario **(6)**
- 2.9** Give **one (1)** basic audit procedure which you can use to test the reliability of each control listed in the scenario **(6)**

[TURN OVER]

QUESTION 3

22 marks

You are an internal auditor at Creative Business, a short-term insurance company. The following applies to the company:

- I The company adheres to the principles of sound corporate governance.
- II The directors' remuneration is largely dependent on the company's financial results.
- III Management decisions are strongly influenced by the managing director, a clever but forceful, autocratic man.
- IV Recommendations made by the internal auditors to the management of the company at the conclusion of the audit are implemented in good time.
- V The financial director shows little regard for the external auditors, describing the annual audit as an irritation.
- VI The company has converted itself from a complex corporate structure to a more simple structure by unbundling itself.
- VII The staff in the information technology department are very inexperienced.
- VIII The company's motto is "no question – we will be number one" and employees are encouraged to be aggressive and competitive as progress depends upon results.

REQUIRED

Marks

- 3.1 Explain the internal auditor's responsibility in respect of the prevention and detection of fraud by referring to the Standards. (6)
- 3.2 Indicate whether each of the above conditions will **increase** or **decrease** the risk of fraud in the company. Give reasons for your answer. (16)

Use the following format to answer the question:

Question No.	Increase or decrease	Motivation
(I)		
(II)		