

**AUI2601**

October/November 2012

INTERNAL AUDITING: THEORY AND PRINCIPLES

Duration 2 Hours

100 Marks

EXAMINERS :

FIRST

SECOND

MRS D SEBASTIAN

MRS JP DOSTER

MRS BM VAN WYK

PROF JM VAN STADEN

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	15
2	International Professional Practices Framework (IPPF)	20
3	Reporting lines of Internal Audit	10
4	Roles of internal auditors	25
5	Internal audit qualifications and characteristics	10
6	The internal audit process	<u>20</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.

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QUESTION 1

15 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 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 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

1.2 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

- 1.3** 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
- 1.4** Working papers serve the following purpose for the internal auditor.
- A provide the auditee a place to give responses to audit recommendations
 - B provide the principal evidential support for the internal auditor's report
 - C provide a place to summarise overall audit recommendations
 - D make the audit report more readable by providing a place to append exhibits
- 1.5** According to the International Standards for the Professional Practice of Internal Auditing (Standards), due professional care calls for
- A infallibility and extraordinary audit performance when the system of internal control is inadequate
 - B detailed audits of all transactions related to a particular function
 - C testing transactions in sufficient detail to give absolute assurance that non-compliance does not exist.
 - D consideration of the possibility of material errors and irregularities during an audit assignment.

[TURN OVER]

- 1.6** The most important benefit provided by the audit committee to the internal auditor is to .
- A approve audit plans and to schedule meetings with the internal auditor
 - B protect the independence of the internal auditor from undue management influence
 - C. review annual audit plans and monitor audit results
 - D review copies of the procedural manuals for selected company operations and discuss such manuals with a company official
- 1.7** 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. Common understanding of the respective audit reports and presentations to management.
 - B Periodic meetings to discuss general economic growth and market direction
 - C Exchange of audit reports on matters of mutual interest.
 - D. Dual use of audit clerks for audit activities
- 1.8** 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

[TURN OVER]

- 1.9** 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.
- 1.10** 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

(Questions adapted from Vallabhaneni: CIA Exam Review)

QUESTION 2

20 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)

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REQUIRED

Marks

- 2.1** Briefly define and explain each of the following terms:
- a) the Definition of Internal Auditing (4)
 - b) the Code of Ethics (3)
 - c) the International Standards for the Professional Practice of Internal Auditing (Standards) (4)

(TUT Exam February 2012 adapted)

- 2.2** Conclude and explain, with reference to the Institute of Internal Auditors (IIA) Code of Ethics, whether each of the scenarios below is permissible in terms of the **IIA Code of Ethics**. Please provide reasons for each of your conclusions
- 2.2.1** Martin, an internal audit manager, engages in the preparation of income tax forms during the tax season. He prepared the personal tax return, for a fee, for one of the company's divisional managers. (3)
- 2.2.2** James, a senior internal auditor told his friend to start looking for a new job as an audit of the executive office indicated that the friend's division was going to be closed down in about six months (3)
- 2.2.3** An internal auditor disclosed confidential, engagement-related information that was potentially damaging to the organisation, in response to a court order (3)

(Gleim CIA Review adapted)

QUESTION 3

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

- 3.1** Discuss the advantages and disadvantages of reporting to the Audit Committee (3)
- 3.2** Discuss the advantages and disadvantages of reporting to the CEO (3)
- 3.3** According to the IIA Standards, recommend what type of reporting is (4)

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preferred for independence purposes

QUESTION 4

25 marks

You recently attended a conference jointly organised by the Association of Certified Fraud Examiners and the Institute of Internal Auditors.

The theme of the conference was **"The diverse roles of internal auditors in today's world"**

The Chief Audit Executive has asked you to prepare a brief presentation as a way of sharing with your colleagues what you learnt at the conference. He asked that your presentation should cover at least a discussion of fraud, control and governance processes.

REQUIRED

Marks

- | | | |
|------------|---|------------|
| 4.1 | Explain the internal auditor's role in governance processes according to the IIA Standards 2110 –Governance | (6) |
| 4.2 | Explain the role of an internal auditor as a control function in the organisation | (7) |
| 4.3 | Define the different types of control and give an example of each type | (6) |
| 4.4 | Explain the internal auditor's role in the deterrence of fraud | (2) |
| 4.5 | As part of his responsibility for the deterrence of fraud, discuss what steps the internal auditor can take | (4) |

QUESTION 5

10 marks

As part of your company's initiative to be more involved in the community, you have been invited as a guest speaker for the matric students at the nearby high school to inform them of the fascinating world of Internal Auditing

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REQUIRED	Marks
5.1 Describe the formal requirements that potential internal auditors must meet before they can be awarded the professional Certified Internal Auditor (CIA) designation	(4)
5.2 Identify and describe at least six (6) of the personal characteristics required of an internal auditor that would assist him to effectively discharge his duties as an internal auditor	(6)

QUESTION 6 **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	
6.1 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)
6.2 Identify four (4) different types of audit evidence? Define the different kinds of evidence with an example for each kind of evidence	(6)
6.3 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.	(4)

[TURN OVER]

- 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

(Wiley CIA Review, adapted)

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

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