

**AUI2601**

October/November 2013

**INTERNAL AUDITING: THEORY AND PRINCIPLES**

Duration 2 Hours

100 Marks

**EXAMINERS**

FIRST

MRS D SEBASTIAN

SECOND

MRS BM VAN WYK

Use of a non-programmable pocket calculator is permissible

Closed book examination

This examination question paper remains the property of the University of South Africa and may not be removed from the examination venue

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

QUESTION	MAIN TOPIC	MARKS
1	Multiple-choice questions	15
2	Roles and responsibilities of internal auditors	30
3	The internal audit process	35
4	International Professional Practices Framework (IPPF)	<u>20</u>
		<u>100</u>

**PLEASE NOTE:**

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

[TURN OVER]

**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** During an internal audit review of the organisation's accounts payable function, an internal auditor plans to confirm balances with suppliers. What is the source of authority for such contact with parties outside the organisation?

- A Internal auditing departmental policies and procedures
- B The International Standards for the Professional Practice of Internal Auditing
- C The organisation's policies and procedures
- D The internal audit charter

**1.2** Which of the following audit committee activities would be of the greatest benefit to the internal auditing department?

- A Support for appropriate follow-up of recommendations made by the internal audit department
- B Assurance that the external auditor will rely on the work of the internal audit department whenever possible
- C Review and approval of audit programmes
- D Review and approval of all internal audit reports prior to their release

**1.3** The best description of the purpose of internal auditing is that it

- A appraises the efficiency and effectiveness of operations

- B reviews the means of safeguarding assets and, as appropriate, verifies the existence of such assets
  - C provides members of the organisation with information needed to discharge their responsibilities effectively
  - D reviews the reliability and integrity of financial and operating information
- 1.4** Risk management is the responsibility of management. The role of the internal audit activity in the risk management process may include which one of the following?
- A Evaluating the risk management process as part of the engagement plan
  - B Managing the risk management process
  - C Appointing consultants to assist management with the risk management process
  - D All of the above
- 1.5** Which one of the following statements best describes management's objective?
- A Telling people what to do
  - B Making profits
  - C Minimising production costs
  - D Planning, organising, directing and controlling to optimise the utilisation of corporate assets to maximise profits
- 1.6** Which one of the following alternatives forms part of the required personal characteristics of an internal auditor?
- I Practical approach
  - II Extrovert personality

[TURN OVER]

- III Assertive
  - IV Good interpersonal relations
  - A I and II
  - B II and IV
  - C I and IV
  - D II and III
- 1.7** Which one of the following provisions should be excluded from the internal audit charter?
- A The right to attend meetings
  - B The internal audit department's work schedule, staffing plan and financial budget
  - C The independence of the internal auditor
  - D The right to obtain information and explanations from all the employees
- 1.8** Which technique is most appropriate for determining whether mail room staff is fully used?
- A Inspection of documents
  - B Inquiry
  - C Analytical review
  - D Observation
- 1.9** 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. The rule violated in the IIA Code of Ethics is most likely?

[TURN OVER]

- A Lack of competence in the area of fraud examination
  - B Failing to show due diligence
  - C No violation of the Code of Ethics has occurred
  - D Failing to comply with the law
- 1.10** 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 Working papers adequately support the internal audit findings, conclusions and reports
  - D Standard departmental procedures are adhered to with regard to working paper preparation and technique

**(Questions adapted from Vallabhaneni: CIA Exam Review)**

**QUESTION 2**

**30 marks**

You are the chief audit executive (CAE) for Inferno Limited, a company listed on the Johannesburg Stock Exchange (JSE). Recently from your interaction with senior management, you realised that they are not well informed of the roles and responsibilities of internal audit. You compiled a presentation and presented it to the senior management at the next management meeting. At the meeting, some of the managers asked you to explain some issues.

**REQUIRED**

**Marks**

- 2.1** Describe the objective of the internal audit activity **(4)**

[TURN OVER]

- 2.2 The International Professional Practices Framework (IPPF) consists of six (6) elements Name each element **and** state whether each is mandatory or strongly recommended (One mark for each element and ½ mark for classification) (9)

Element	Mandatory/Strongly recommended

For the following questions, explain your answers with reference to the IPPF.

- 2.3 Independence consists of organisational independence and individual objectivity Define the terms “organisational independence” and “individual objectivity” (6)
- 2.4 The Chief Executive Officer (CEO) enquires why the Internal Audit cannot report administratively and functionally to him List two (2) advantages and two (2) disadvantages as to why this reporting line is not recommended (4)
- 2.5 One of the senior managers enquires what happens if a fraud has been detected and management wants internal audit to assist with the investigation Describe the internal auditor’s responsibilities in **investigating** fraud (5)
- 2.6 Identify who is responsible for the coordination of the internal and external auditor's work (2)

### QUESTION 3

35 marks

The internal audit activity plans to perform an audit on the human resource process of Inferno Limited The audit team that will conduct the engagement consists of one internal auditor who is studying towards a degree in internal auditing and one person who has no experience in internal auditing at all Because of other urgent business, you as CAE will not be available to assist the team during the conduct of the audit You explained their duties to them, instructed that audit sampling should be used and all audit evidence should be **sufficient, competent, relevant and useful**. All audits must be conducted according to the Standards

[TURN OVER]

The following is the list of audit activities the audit team followed. The list is in no specific order.

- (a) Gather audit evidence
- (b) Identify opportunities for making significant improvements to human resource's risk management and control systems
- (c) Distribute the audit report
- (d) Perform a preliminary survey for the recruitment process to identify the objectives and significant risks and evaluate the resources
- (e) Complete the audit working papers
- (f) Compile a list of the activity's objectives that must be achieved
- (g) Evaluate the recruitment process based on the risk assessment
- (h) Determine the audit risk and indicate how it will influence the audit engagement
- (i) Perform the audit procedures
- (j) Write the audit report

**REQUIRED**

**Marks**

- 3.1** The internal audit process consists of the following phases/steps **(10)**

Determining audit assignment, Planning the internal audit (engagement planning), Performing the engagement (fieldwork) and Audit reporting and follow up

State in which phase/step of the internal audit process each of the activities listed in the scenario falls

No	Audit phase/step
(a)	

- 3.2** Evaluate and conclude on whether the "Proficiency" requirements of Standard 1210 are complied with by the CAE. Base your answer on the information provided in the question **(3)**

- 3.3** List the factors that determine the nature and scope of audit sampling **(5)**

- 3.4** The audit team was instructed to ensure that all the audit evidence they gather should be **sufficient, competent, relevant and useful**. Define these terms as per the International Standards for the Professional Practice of Internal Auditing (Standards) **(8)**

[TURN OVER]

**3.5** Identify the following controls as **detective, preventative or directive** (9)

- (a) Alarms
- (b) Personnel access cards
- (c) Procedure manuals
- (d) Use of carbon paper
- (e) Guidelines
- (f) Physical stock count
- (g) Reconciliations
- (h) Company policy
- (i) Training programmes

**QUESTION 4**

**20 marks**

All internal auditors are required in the course of their duties to adhere to the elements of the International Professional Practices Framework (IPPF) established by the Institute of Internal Auditors (IIA) You came across the following ethical issues while conducting different audits

**REQUIRED**

**Marks**

Conclude and explain, **with reference** to the IPPF, whether each of the scenarios below is permissible or not Please provide reasons for each of your conclusions

Your solution should be structured as follows

	<b>Permissible/not permissible (1 mark)</b>	<b>Reference to IPPF (2 marks)</b>	<b>Reasons (1 mark)</b>
<b>4.1</b>			

**4.1** During an audit, you overheard that the chief executive officer (CEO) of the company might be resigning due to fraud allegations against him You know people who have shares in the company You decided to inform them about the possibility that the share price may decrease (4)

**4.2** Due to work and personal constraints, Sandra, a senior internal auditor, has not attended any training for the past two years (4)

[TURN OVER]



- 4.3** Simon, the Chief Audit Executive (CAE) disagrees with the engagement client about the observations and recommendations in a sensitive area. The senior management accepts the risk and wants the findings removed from the report. However, Simon reports the matter to the board. **(4)**
- 4.4** The human resource manager's children are going to a school to which you would like to send your own children as well. The school has a very long waiting list because it is so popular. The human resource manager has offered to use her influence as a board member of the school to help gain admission for your children to this school. **(4)**
- 4.5** The internal audit reports prepared by an internal audit activity have for the past seven years always stated that their internal audit activities are concluded in accordance with the Standards for the Professional Practice of Internal Auditing. Regular internal assessments have been performed and recorded. The internal audit activity has never been subjected to an independent assessment of its quality improvement programme. **(4)**

(Gleim CIA Review Adapted)