

Tutorial Letter 202/2/2015

AUI3703

THE INTERNAL AUDIT PROCESS: SPECIFIC ENGAGEMENTS AND REPORTING Semester 2

Department of Auditing

This tutorial letter contains important information about your module.

Bar code

QUESTION 1: (15 marks)

- 1.1 D
- 1.2 A
- 1.3 B
- 1.4 C
- 1.5 B
- 1.6 B
- 1.7 C
- 1.8 B
- 1.9 A
- 1.10 C

(1½ marks each)

Comments on Question 1**1.1 – D (study guide, section 3.2.1)**

Option D is correct as an internal audit activity can facilitate the organisation's preparation of adequate performance measurement during a performance audit. Performance auditing involves an appraisal of the performance of the organisation that is being investigated.

Option A is not correct as a risk assessment and risk profile will not be done during a performance audit, it refers to a risk audit.

Option B is not correct as it refers to a financial audit and a financial audit performed by external auditors.

Option C is not correct as fraud awareness and corporate governance are not likely to be included in a performance audit.

1.2 – A (study guide, section 3.2.4)

Option A is correct as economy is the relationship between actual inputs and planned inputs.

Option B is not correct as planned inputs and planned outputs do not refer to any of the three E's.

Option C is not correct as actual input and actual output refer to efficiency.

Option D is not correct as actual outputs and planned outputs refer to effectiveness.

1.3 – B (study guide, section 3.2.4)

Option B is correct as proper operational standards refer to the economy and efficiency of the operations.

Option A is not correct as the existence and safeguarding of assets do not form part of economy and efficiency.

Options C and D are not correct as they do not refer to a performance audit.

1.4 – C (study guide, section 4.4)

Option C is correct as the first step the internal auditor needs to do, when fraud is suspected, is to

inform the appropriate managers within the organisation thereof.

Option A is not correct as an independent investigation team are not always appointed.

Option B is not correct as employees cannot be suspended without an investigation being conducted or without the approval of the organisation's management.

Option D is not correct as you cannot interrogate the suspect without conducting an investigation first.

1.5 – B (study guide, section 4.3)

Option B is correct as a monthly report approved by a manager and an approved report of the hours worked will limit the chance of creating or paying a fictitious employee.

Option A is not correct as there are no approval steps in place and the employee will be able to create fictitious employees without approval.

Option C is not correct as a supervisor outside the payroll and human resource department will not be able to identify fictitious employees and will also not know whether all employees are really employed by the company.

Option D is not correct as the employee work in the payroll department and can therefore take the pay cheque themselves.

1.6 – B (study guide, section 3.2)

Option B is correct as the scope of a comprehensive performance audit will include all three E's namely economy, efficiency and effectiveness.

Option A is not correct as efficiency refers to the relationship between actual outputs and actual inputs.

Option C is not correct as findings should not be reported directly to the board of directors or audit committee; a management summary should be forwarded to the board of directors.

Option D is not correct as not only frauds reported to the audit committee should be investigated. All suspicions of fraud should be investigated before it is reported to management.

1.7 – C (study guide, section 3.2)

Option C is correct as the implementation of a centralised purchasing system will relate to the effectiveness of the new purchasing system implemented.

Options A, B and D are not correct as these options will not address the effectiveness of the newly implemented system.

1.8 – B (study guide, section 4.1)

Option B is correct as the evaluation of adequate controls by internal auditors will be seen a deterrence of fraud.

Options A, C and D are not the responsibilities of the internal auditors and are the responsibilities of the management of the organisation.

1.9 – A (study guide, section 4.1)

Option A is correct as lost deposit slips can point to embezzlement of cash as there will be no proof whether or not the cash was actually deposited into the bank account.

Options B, C and D do not refer to embezzlement of cash.

1.10 – C (study guide, section 4.3)

Option C is correct as the internal auditor cannot draft and implement the policies and procedures for the department and it will therefore be the responsibility of the supervisor.

Option A is not correct as the internal auditor cannot document, distribute and implement policies and procedures.

Option B is not correct as it is not the responsibility of the internal auditor to implement improvements.

Option D is not correct as a compliance audit in six months will not ensure that future fraud is eliminated.

QUESTION 2: (51 marks)

2.1 Discuss the mission in the context of organisational performance and elaborate on the relationship between mission and performance objectives.

Reference: Study guide, section 3.2.5

The mission of ReadAlot is the reason for the existence of the company and gives expression to what the company wants to achieve.(1)

ReadAlot's mission can be seen as its primary performance objective. (1) A performance objective is a clear statement of what the company wants to achieve. (1) All the performance objectives must be achieved if the undertaking wants to achieve its mission. (1)

If a single performance objective is not achieved, the mission of ReadAlot is also not fully achieved. If the mission of ReadAlot can be compared to a completed puzzle, then the puzzle pieces are the performance objectives and the puzzle will only be complete if all the pieces are in place. (1)

(Marks as indicated, maximum 5 marks)

Comment

In this question you had to provide a definition of the mission statement. You should establish the link between the mission statement and the performance objectives. This is a theoretical question and easy to obtain marks. Ensure that you study all theory well.

2.2 Steps to follow when evaluating the mission statement of ReadAlot.

Reference: Study guide, section 3.2.5

When assessing the mission of the organisation, the internal auditor must first determine whether the mission has been established and communicated to all relevant parties.(1)

If the mission has not been established the internal auditor need to report this and the potential impact to top management and/or the audit committee.(1)

The internal auditor needs to assess the following:

1. That the mission statement has been formally defined. Without a mission statement the organisation will be without direction.(1)
2. That the mission statement conveys the organisation's reason for existence. To assess this the internal auditor must have a good understanding of the organisation, particularly regarding its purpose. The internal auditor must report any shortcomings to top management.(1)
3. That the mission statement has been translated correctly into performance objectives.(1)
4. That managers are keeping their mission statements in line with the changing needs and wants of their customers.(1)
5. In publicly funded organisations, that the organisation's reason for existence is still valid, customer's still have a genuine need for the service provided.(1)

When assessing the quality of the organisation's mission, the internal auditor must exercise diplomacy. Managers don't take kindly to being told bluntly that their objective statement is wrong. Point out shortcomings and suggest improvements.(1)

(Marks as indicated. Maximum 6 marks)

Comment

This is a theoretical question. All that was required was for you to list the steps that you would follow when evaluating the mission statement of ReadAlot.

2.3 Weaknesses directly impacting the effectiveness of the administrative department.

Reference: Study guide, par 3.2.2

- Targets and objectives set for the departments are not realistic.
- The approach to developing targets and objectives are not clear.
- No detailed plans regarding objectives and targets were communicated to the staff members.
- No feedback on the achievement of targets were provided to the staff members.
- There are no formal guidelines or procedures in place for the administrative department.
- Targets are not in line with the mission statement of ReadAlot.
- Targets set for the department are not realistic.

(1 mark for each correct weakness identified. Maximum 5 marks)

Comment

This is a practical question and you need to read your question carefully to be able to identify the weaknesses. Work systematically through the question and write down all the weaknesses provided in the question, then highlight the ones that relate to effectiveness and that will be the weaknesses that you will include in your answer. Ensure that each weakness can be linked to effectiveness. You need to know your theory well in order to be able to answer practical questions.

2.4 Five (5) audit techniques that may be used in the performance of this audit and describe how each of them will be used to audit the effectiveness of the administrative department.

Reference: Study guide, section 3.2.3

Examine existing documentation, such as policy and procedure manuals to establish whether criteria for measuring the performance of the administrative department has been formalised and whether they are accurate.

Analyse policy and procedures to establish whether they are clear and will lead to the achievement of the goals set by the management of ReadAlot.

Hold **interviews** with the headmaster and facilitator to determine whether they are informed about the Department of Education's mission, performance standards and measuring criteria and whether there are any issues that may hamper the achievement of objectives.

Analyse rates, changes and trends by performing analytical review procedures on the operations of the administrative department.

Send **questionnaires** to the staff members, to determine factors which may hamper the achievement of objectives.

Interviews with management of the department to ascertain the achievement of objectives.

Review reports to determine compliance with policies and procedures and the achievement of objectives.

(One mark for any of the above or other valid technique and one mark for the correct application to measure effectiveness. Maximum 10 marks)

Comment

This question is a typical question where you need to combine your theoretical knowledge obtained from studying this module. You had to mention the audit technique, for which a mark would have been awarded. You then had to link the audit technique with the effectiveness of the administrative department. A starting point is to write down the aspects that relate to the effectiveness of the department, and then link each aspect with a specific audit technique. Ensure that you do not use one audit technique more than once, as you will only receive a mark the first time you mention the specific technique.

2.5 Formulate ten (10) questions to put to ReadAlot's management to gain background information on the efficiency of the administrative department.

Reference: Study guide, section 3.2.3

- Are the administrative processes divided into logically manageable tasks or are there areas where the processes could be improved?
- What adjustments would you make to the administrative processes in order to improve the manageability of the administrative processes? Provide details.
- To what extent is the capacity of your machines and staff utilised?
- In which areas do you experience capacity shortages?
- Is your staff satisfied with their workload or have you received any complaints regarding this issue recently?
- In which areas can documentation flow be improved to be more efficient?
- Are there any areas where unnecessary tasks are performed or where tasks are duplicated? Provide details.
- In which areas could the allocation of responsibilities and authority within the administrative department be improved?
- How does the speed of production and completion time for projects in your department compare to that of other departments in the industry?
- What process is in place to minimise wastage?

(1 mark per question that will provide background information on the efficiency of the plant. Maximum 10 marks.)

Comment

In this question you had to list the questions that you would ask the manager of the administrative department regarding the efficiency of the administrative department.

A starting point will be to list all the aspects that relate to efficiency (refer to section 3.2.2 of your study guide). Once you have written down all the aspects, formulate a question for each aspect and relate it back to the information provided to you in the question.

Make sure you ask open-ended questions as a simple "yes" or "no" answer will not provide you with any additional information. No marks will be awarded for questions that do not relate to efficiency or where the answer will not provide additional information.

2.6 Ten (10) qualities and abilities an operational auditor should possess

Reference: Study guide, section 2.2

1. Curiosity
2. Analytical qualities
3. Qualities of persuasion
4. Good business judgement
5. Logical thinking
6. Objectivity
7. Good communication skills
8. Good human relations
9. Independence
10. Self-confidence
11. Initiative in developing techniques

(½ mark each for any valid quality/ability mentioned. Maximum 5 marks)

Comment

This is a theoretical question and very easy marks. You had to list the qualities and abilities of an internal auditor. As you can see it is very important to study all theory well.

2.7 Develop a complete audit finding based on the information obtained from the distribution department in which you specifically mention and practically illustrate all the different elements of an audit finding.

Reference: Study guide, section 7.1.2.3

Finding/ Condition: (½)	All orders are not delivered within 24 hours as specified in the sales agreement.	(½)
Criteria: (½)	All orders should be delivered within 24 orders as specified in the sales agreement.	(½)
Cause: (½)	Staff shortage	(½)
Effect: (½)	ReadAlot will incur financial losses due to the 10% discount given to customers if the orders are delivered late. Reputational damage.	(½)
Recommendations (½)	Appoint temporary staff or additional staff members to ensure that all orders are packed and delivered within 24 hours..	(½)

(Marks as indicated, maximum 5 marks)

Comment

*An audit finding should always consist of **condition**, **criteria**, **cause**, **effect** and **recommendation**. You had to use the information provided to you in the question to formulate the finding. Read through the information provided in the question again carefully*

and identify the information that relates to each of the elements of the audit finding. First write down all the elements and then add the information from the question to formulate an audit finding.

It is imperative that you know the theory well as you will not be able to identify the required information for each element if you do not understand the underlying theoretical concepts.

2.8 Weaknesses directly impacting on the efficiency of ReadAlot.

Reference: Study guide, section 3.2.2

- Too many manual procedures in place that could be automated to improve efficiency.
- Duplication of tasks within the packaging department.
- No policies or procedures regarding the activities within the packaging department.
- Staff shortages exists within the packaging department.
- Staff working in the packaging department is overworked.

(1 mark for each correct weakness that relates to efficiency. Maximum 5 marks)

Comment

To obtain the maximum marks in the question you need to know the definition of efficiency. You had to work through the information provided in the scenario and identify all the weaknesses and then you had to write down all the weaknesses that directly impact the efficiency of ReadAlot. All the weaknesses are listed in the scenario and you just had to identify whether it relates to efficiency.

QUESTION 3: (34 marks)

3.1 Identify the weaknesses in the distribution department's operating procedures, that would encourage fraudulent behaviour and for each weakness, briefly describe why this would be the case.

Reference: Study guide, section 4.3

1. Drivers are appointed on a contract basis and paid a fixed rate per hour. They work a lot of overtime and there is little time for oversight.

Staff may put in claims for more hours than they have actually worked.

2. Little time for manager-employee interviews and oversight.

Staff may be paid for unproductive hours.

3. The company doesn't advertise for new programmers, as they have a pool of friends and family of existing staff members to select from.

Staff may be appointed without proper vetting being done, leading to the employment of dishonest staff.

4. The culture of the company is trusting with very few rules. A new person starting there, only have to sign an agreement that they have a valid driver's license.

No clear policies setting out the tone at the top and acceptable staff behaviour.

5. A staff member got fired recently, but although the reason was rumoured to be fraudulent behaviour, nobody really knew the reason.

Lack of communication between management and staff may lead to similar incidents in future.

(Two marks each, maximum 10 marks.)

Comment

This is a practical question, but students tend to do well in identifying the weaknesses as the answer can be found in the question. With a question like this, read through the information provided to you in the question and work through it line by line; identify the weaknesses mentioned in the question and write down every weakness you can identify. In this question you should also include a reason why the specific weakness exists. For this question you need to apply your theoretical knowledge to answer the question to the best of your abilities.

3.2 Eight (8) audit procedures that can be used to determine whether the new delivery vans has been economically procured

Reference: Study guide, sections 3.2.2

1. Analyse the purchasing policy of ReadAlot with regard to the purchase of new delivery vans and ensure that the policy is such that the new vans can be economically procured.
2. Evaluate the procedures followed when purchasing the delivery vans and ensure that the procedures followed are in line with the purchasing policy and that the vans purchased was purchased at the best price. Specifically note the tender procedures, specification of the delivery vans etc.
3. Discuss the amount spent on procuring the vans with management and ensure that there are valid reasons for the purchase of the delivery vans.
4. Ensure that cost-benefit studies were completed before the vans were purchased.

5. Analyse the finance terms of the purchased delivery vans, for example was it bought on a hire-purchase agreement, for cash or with a loan. Ensure that the finance method used is the most beneficial for the company.
6. Review the capital usage schedules and ensure that vehicles will be used optimally.
7. Ensure that the replacement policy provides for the economical use of delivery vehicles.
8. Ensure adherence to the purchasing and replacement policy.

(1½ mark each, maximum 12 marks.)

Comment

In this question you had to apply the theoretical knowledge you have about economy and use that knowledge to formulate audit procedures. A general problem is that students formulate audit procedures that do not refer to economy. For this question write down all the aspects that relate to economy and then formulate an audit procedure that relates to each of those aspects, taking into account the information provided in the question.

Note: No marks will be allocated if the audit procedures are not correctly formulated!

3.3 Factors that motivate people to commit fraud.

Reference: Study guide, section 4.2

Firstly, there may be pressure on the individual, either internal pressure in the form of debt or a desire for riches (1), or external pressure in the form of pressure exerted by the organisation on management to achieve projected profit figures and adhere to budgets. (1)

Secondly, opportunity. Uncontrolled access to organisational assets tempts employees to misappropriate these for their own profit. (1)

Thirdly, personality disorders (lack of ethics) may exist. Most people generally prefer to be honest, but unfortunately there are the exceptions who prefer to be dishonest. (1)

(Marks as indicated. Maximum 3 marks)

Comment

This is a theoretical question and an easy question to obtain marks in. You merely had to list the factors listed in section 4.1

3.4 Indicate how the tasks of an internal auditor during a fraud investigation would differ from the tasks performed during a performance audit of the distributions department.

Reference: Study guide, section 4.3

A fraud investigation is geared to detection. (1) During a fraud investigation the internal auditor's tasks involve the following:

- looking for evidence supporting an identified irregularity,(1)
- determining the particulars of the irregularity,(1)
- quantifying the loss or scope of the problem and the period in which it took place, the method used and the persons involved, (1)
- acting as a gatherer of information and evidence. (1)
- recommendations to prevent the fraud from happening again. (1)

In a performance audit, the auditor's tasks consist of the following:

- looking for symptoms that indicate that problems may exist with economy, efficiency and effectiveness, (1)
- looking for weaknesses in the system, or susceptibility of the system to problems, (1)
- making recommendations for improving efficiency, economy and effectiveness, (1)
- reassuring management, (1)
- emphasising compliance with developed procedures and controls and improving them. (1)

(Marks as indicated. Maximum 10 marks)

Comment

For this question you had to list the steps that you would follow during an operational audit and compare it with the steps that you would follow during a fraud investigation. To ensure that you cover all aspects, list both the steps followed during a performance audit and the steps followed during a fraud investigation.

General comments

Read your questions carefully to ensure that you understand each question, and then answer it correctly. Ensure that you take the mark allocation for each question into account so that you write enough to obtain all the marks possible. Study your theory well, as the theory forms the basis of all the questions, and you will not be able to answer the questions unless you know the theory. Study all the sections and ensure that you can answer both theoretical and practical questions.

Good luck with the examination.