

# **Tutorial Letter 203/2/2016**

**AUI3703**

## **THE INTERNAL AUDIT PROCESS: SPECIFIC ENGAGEMENTS AND REPORTING**

**Semester 1**

### **Department of Auditing**

This tutorial letter contains important information about your module.

Bar code

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## 1. BRIEFING

This tutorial letter contains the solutions to Assignment 02 for this semester. The lecturer has marked a selection of the questions in this assignment. The marks you received for your answers to these questions will constitute your mark for this assignment and will contribute towards your year mark.

You need to assess your answers to the other questions yourself by comparing your answers to those provided in this tutorial letter.

Use the marking plan as a guide to award yourself marks for your answers. Take care not to mark the same concept more than once just because it appears more than once, perhaps in different words or in a different format.

After you have marked your own answers, please reflect carefully on your result to determine why you could not allocate full marks to your answers. Please ensure that you allocate marks only to valid answers. It is imperative that you identify your problem areas now, while you can still do something about them. If you do not solve all your problems as soon as you have identified them, you may repeat the same mistakes in the examination, and that could prove very costly.

Marking your answers should enable you to identify any problems you may be experiencing. Your marks for this assignment will be an indication of your level of knowledge of the module content at this stage. You should still have enough time left to revise the work and solve the identified problem areas before the examination.

We trust that you have found the assignment both interesting and informative and that it has served as an aid for your examination preparation. Should you encounter any difficulties regarding this module in internal auditing, please do not hesitate to contact us.

Lecturer: AUI3703

## 2 KEY TO ASSIGNMENT 03/2016 (FIRST SEMESTER)

### QUESTION 1: (12 marks)

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

(1½ marks each)

#### **Comments on Question 1**

##### **1.1. C (study guide, section 3.2.4)**

Option C is correct as the relationship between actual outputs and planned outputs refers to effectiveness.

Option A, B and D are all incorrect. Refer to diagram 1.2.3 in the Studyguide.

##### **1.2. A (study guide, section 7.1.2)**

Option A is correct as the effect section of the audit finding quantifies the impact of the deficiencies and encourages management to take corrective action.

Option B refers to the cause

Option C and D refers to the criteria/ standard

##### **1.3. A (study guide, 6.1.2)**

Option A is correct as the assurance services consist of examination of evidence for the purpose of providing an independent assessment of control process.

Option B, C and D are example of consulting services.

##### **1.4. C (study guide, section 5.3.2.)**

Option C is correct as general controls control access to data and programs.

Option A is incorrect as application controls control access to specific program function to

ensure the validity, processing and output.

Option C and D are not relevant

### 1.5. D (study guide, section 1.2.2)

Option D falls under the strongly recommended guidance

Options A, B and D are all mandatory guidance.

### 1.6. B (study guide, section)

Option B is correct, because each individual manager will be given an equal opportunity to table his/her concerns.

Option A, C and D will not help with addressing resistance to change by management.

### 1.7. B (study guide, section 7.1.2)

Option B is correct as the likelihood is more than remote and the impact exceeds the materiality threshold.

Option A is incorrect as the impact is trivial.

Option C is incorrect as the likelihood is remote and the impact is trivial.

Option D is incorrect as the likelihood is poor and has an insignificant effect.

### 1.8. D (study guide, section 5.2.2)

Option D is correct as the audit risk formula is  $\text{audit risk} = \text{inherent risk} \times \text{control risk} \times \text{detection}$ . Business risk does not form part of the equation.

## QUESTION 2: (63 marks)

### Study unit 4.1 Answer to activity 10

(15 marks)

#### 1. Elements of fraud present in the bank official's behavior

- Unlawful and intentional - The actions of the bank official were intentional. Approving loans to fictitious companies and then appropriating the funds for own use was intentional, because she was aware that her actions were unlawful and that the bank would incur a loss as a result.
- Misrepresentation - The bank official made a purposeful misrepresentation to the

bank by creating the impression that the bank was lending money to companies, while she misappropriated the funds for herself.

- Prejudice - The actions of the bank official caused actual prejudice for the bank as the loan installments were not paid and the bank was not able to recover the money.

(3 Marks for each element and explanation thereof. Maximum 9 marks)

## **2. Warning signals reinforcing the suspicion that the bank official probably committed fraud**

- The bank official owns a luxury house and motor cars but she earns an average income.
- She gets on well with everybody in the bank, and does favours for management.
- She works more overtime than any other official at the bank.
- She never takes any leave.
- The bank official appears to be nervous during the audit and is unwilling to answer questions, even though she seems to get on well with everybody.

(Maximum 6 marks.)

### **Comments**

This is a theoretical as well as an application question. When a scenario is given, the answer must relate to the information given in the scenario.

## **Study unit 4.1 Answer to activity 11**

(10 marks)

### **Incident 1**

This incident is clearly fraud. The fact that the amount is small is not important as an amount was unlawfully and intentionally misrepresented as casual wages.

### **Incident 2**

This incident is clearly fraud. The procurement officer received a 25 % kickback for all orders placed with the company. This incident is unlawful and intentionally done by the procurement officer. The additional costs are misrepresented as advertising costs.

### **Incident 3**

This incident is an indication of possible fraud that might have been committed. The information is not sufficient to decide whether or not fraud was committed. Additional evidence will have to be collected in order to prove or disprove that there was an unlawful act, an intention to defraud and misrepresentation.

## Comments

This was the practical application of the principles of fraud in a given scenario. When answering such a question always refer back to the underlying theory to substantiate your answer.

### Study unit 4.4 Answer to activity 12

(10 marks)

#### 1. Whether or not John Smit's actions with regard to overtime claims would be regarded as fraud in the context of the South African definition of fraud.

John Smit's actions can be seen as fraud in terms of the South African definition of fraud as all four elements of fraud are present. Both the intention to deceive as well as the intention to defraud the company is present in John Smit's behaviour.

- a) John misrepresented information by making unauthorised changes to the claim forms of the employees working for him.
- b) The company incurred financial losses by paying excessive overtime for work not performed; the financial loss is referred to as prejudice.
- c) Any fraudulent misrepresentation is unlawful. Any unauthorised changes made to the claim forms can be seen as unlawful.
- d) John Smit's actions were intentional as he knew that they would lead to unauthorised payments made to individuals, which could lead to financial losses.

(Maximum 4 marks)

#### 2. Red flags that could indicate the possibility of the theft of paint

- Shortfalls in the paint-on-hand figures
- Recent shortage of paint
- Numerous corrections to the paint-on-hand figures
- Delivery of paint to a new address
- John and Jack Smit's dramatic lifestyle changes
- Jack Smit not taking leave
- Jack Smit declining several opportunities for promotion

(Maximum 3 marks)

#### 3. Factors that motivate people to commit fraud

- Firstly, there may be pressure on the individual, either internal pressure in the form of debt or a desire for riches, or external pressure in the form of pressure exerted

by the organisation on management to achieve projected profit figures and adhere to budgets.

- Secondly, opportunity in the form of uncontrolled access to organisational assets tempts employees to misappropriate them for their own profit.
- Thirdly, personality disorders (lack of ethics) may exist. Most people generally prefer to be honest, but unfortunately there are the exceptions that prefer to be dishonest.

(Maximum 3 marks)

### **Comments**

This was the practical application of the principles of fraud in a given scenario. When answering such a question always refer back to the underlying theory to substantiate your answer.

### **Study unit 5 Answer to activity 13 (5 marks)**

You would mention the five different steps of the IT audit process and give a short description of each step. Refer to steps 1 to 5 on pages 136-139 in the Study guide in study unit 5.1.2

### **Study unit 5 Answer to activity 14 (9 marks)**

The information security policy should provide the fundamental guidelines used in assessing the value of the information assets and the impact should an untoward event occur. (2)

The following information should be included:

- Information is an important asset of the organisation and must be protected as such.
- By protecting information assets, the organisation will comply with all applicable laws and regulations and will ensure that its employees do so as well.
- Access to information will be granted to individuals when required for the performance of their business functions.
- Confidentiality of information will be maintained.
- Information must be appropriately protected against unauthorised modification.
- Information will be available as and when required to support the authorised and the judgement business functions of the organisation.
- The appropriate control structures must be implemented to ensure the integrity, confidentiality and availability of information.

### **Comments**



This was a theoretical question. The answer is available in your studyguide.

**Study unit 6 Answer Activity 15 (4 marks)**

To answer this question you need to provide the definition of both assurance and consulting services. You should therefore ensure that you can explain the difference between assurance and consulting services.

**Comments**

Ensure that you work through exhibit 12-2 in your textbook – examples of internal audit assurance and consulting engagements.

**Study unit 7. Answer Activity 16 (5 marks)**

Feedback on the above statements:

1. A & B
2. C
3. C
4. E
5. D
6. B
7. A
8. B
9. D
10. B & E

**Comments**

This was the practical application of the principles of report writing. When answering such a question always refer back to the underlying theory to substantiate your answer.

**Study unit 7 Answer Activity 17 (5 marks)**

Our analysis of the use of fleet vehicles by your staff for the year ended 30 June 20XX indicated the following:

**Description of the condition**

- a. Of the 87 vehicles in the vehicle fleet, 24 vehicles are not used sufficiently to justify their cost. It would be more economic for the organisation to allow those employees to use their own vehicles and then remunerate them for the kilometres covered at the present rate of R1.20 per kilometre.
- b. On the other hand there are 37 employees who make so much use of their own vehicles for official trips that the remuneration they receive annually at R1,20 per kilometre exceeds the cost of leasing a vehicle and allocating it to them permanently.

**Criteria**

In this business sector it is general practice to lease vehicles and allocate them to personnel in cases where the lease costs are lower than the allowance that would be paid to the employee for official trips at the prevailing tariff.

**Cause**

At present there is no procedure for analysing the utilisation of company vehicles and private vehicle allowances for official purposes for a specific period. As a result the present state of affairs has developed over a number of years.

**Effect**

The present situation has resulted in losses to the organisation of over R50 000.00 per year.

**Recommendation**

We recommend that the organisation should implement a procedure for monitoring the utilisation of company vehicles and private vehicles on a continuous basis. The present state of affairs should be rectified by revising the allocation of company vehicles in accordance with the attached schedule, which would lead to an annual saving of at least R50 000, 00.

**Comments**

This was the practical application of the principles of report writing. When answering such a question always refer back to the underlying theory to substantiate your answer.

**QUESTION 3:** (25 marks)

**3.1 List the warning signs given in the scenario that could have aroused suspicion that Jane was involved in fraudulent activities.**

**Reference:** Study guide, section 4.1

- Jane refuses to take lunch, claiming she is on a diet.
- Jane takes full control of all cash transactions.
- Jane volunteers to work extra shifts and weekends.
- Recons are not performed on a regular basis.

- There are no policies or procedures in place regulating the cash transactions.
- Dramatic lifestyle changes for Jane, re the expensive car, clothes etc.
- There are two cash books in use at the reception area.
- No segregation of duties.
- Management's attitude regarding the policies and procedures and trusting their employees in full.

(1 mark for each weakness correctly identified. Maximum of 8 marks.)

### **3.2 Seven (7) recommendations to improve internal controls related to cash transactions.**

**Reference:** Study guide, section 4.4

- Implement policies and procedures regarding the receipt of cash and communicate them to the staff.
- One official cash book should be in use and a manager should sign all cash transactions. No other books allowed at the reception area.
- Segregation of duties when cash is received. Jane cannot have full control over the cash receipt functions.
- Recons should be performed on a daily basis between the cash received and the cash book.
- Employees should be rotated on a regular basis.
- An ethical culture should be implemented, starting with the tone at the top.
- Management should ensure that all employees take lunch and their leave on a regular basis.

(One mark for each valid recommendation made. Maximum of 7 marks)

### **4.4 Briefly discuss the key components of a fraud risk management program that Seafront should take into account when implementing their own fraud risk management program.**

**Reference:** Study guide, section 4.2.3

Commitment by the board and senior management. (1)

Fraud awareness activities that help employees understand the purpose, requirements and responsibilities of the program. (1)

An affirmation process that requires employees self-disclose potential or actual conflict of interest. (1)

A conflict disclosure protocol or processes that help employees self-disclose potential or actual conflicts of interest. (1)

Fraud risk assessment, which helps to identify all reasonable fraud scenarios. (1)

Reporting procedures and whistle-blower protection that provide a well-known and easy avenue for individuals, whether inside or outside the organisation, to report suspected violations or incidents.

An investigation process that ensures all matters undergoes a timely and thorough investigation, as appropriate. (1)

Disciplinary and/or corrective actions that address non-compliance with established policies and help deter fraudulent behaviour. (1)

Process evaluation and improvement to provide quality assurance that the program will continue to meet its objectives. (1)

Continuous monitoring to ensure the program consistently operates as designed. (1)

(Marks as indicated. Maximum 10 marks)