

Tutorial Letter 203/1/2017

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 03 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 02/2016 (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

(1 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, section 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 behaviour

- 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 instalments 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

(19 marks)

3.1 Briefly differentiate between assurance engagements and consulting engagements and for each of the requests listed in 1 to 3, indicate whether it will form part of an assurance or consulting engagement.

Reference: Study guide, section 6.1

Preferred Answer:**1. The primary purpose of the engagement**

- The primary purpose of the assurance engagement is to assess evidence relevant to subject matter of interest to someone and provide conclusion regarding the subject matter
- The primary purpose of internal consulting service is to provide advice and other assistance, generally at the specific request of engagement customers.

2. Who determines the nature and scope?

- In the assurance engagement, the internal audit function determines the nature and scope.
- In the consulting engagement, advice are provided at the specific request of engagement customers.

3. The parties involved

- The assurance engagement generally involves three parties, the auditee, the internal auditor and the user.
- The consulting engagement generally involves two parties; the customers seeking the advice and the internal auditor offering the advice.

1 mark per difference. Needed to provide an explanation of the differences in order to get the mark.

Also marked:

Assurance services – An objective examination of evidence for the purpose of providing an independent assessment on governance, risk management and control processes for the organisation. (1½)

Consulting services – Advisory and related client service activities, the nature and scope of which are agreed with the client, are intended to add value and improve an organisation's governance, risk management and control processes without the internal auditor assuming management responsibility. (1½)

- 1 Consulting service (1)
- 2 Assurance service (1)
- 3 Consulting service (1)

(Marks as indicated. Maximum of 6 marks.)

3.2 CAATs should be applied correctly during the audit process. Describe the audit functions that CAATs can best be used for during the audit process.

Reference: Study guide, section 5.4

- Sorting and file reorganisation. Data can be sorted by date, customer name, department name etc. (1)
- Summarisation, stratification and frequency analysis. Data can be summarised in account number order and the frequency with which certain items are bought. (1)
- Extracting samples, exception reporting, file comparison etc.(1)
- Analytical review, for example extraction of ratios.(1)
- Casting and recalculation. (1)
- Examining records for inconsistencies, inaccuracies and missing data and creating reports. (1)

(Marks as indicated. Maximum of 6 marks)

3.3 For each of the controls listed in 1 to 7 indicate whether they are general controls or application controls.

Reference: Study guide, section 5.3

1. General control
2. General control
3. General control
4. Application control
5. General control
6. Application control
7. Application control

(One mark for each control correctly identified. Maximum 7 marks)

QUESTION 4**(19 marks)****4.1 Based on the information provided regarding the access controls, complete the audit finding that will be included in the internal audit report.**

Reference: Study guide, section 7.1

Finding/

Condition: No access controls are in place at the warehouse. (1)

Criteria: Access to the warehouse should be controlled as there is very expensive solar equipment kept in the warehouse. (1)

Cause: The access card machine is not working. (1)

Effect: Financial loss. Theft of solar equipment. (1)

Recommendation The access card machine should be fixed as soon as possible (½), but in the meanwhile an additional control such as a security guard at the entrance with a security register should be on duty while the warehouse is open.(½) Only necessary staff should be able to access the warehouse after hours and this should be logged as well.

(Marks as indicated. Maximum 5 marks)

4.2 Briefly describe what a well-designed final communication should include.

Reference: Study guide, section 7.2

- Purpose and scope of engagement (½)
- Time frame covered by the engagement (½)
- Observations as required by the evaluation and escalation process (½)
- Engagement conclusion and rating (½)
- Management's action plan to appropriately address reported observations. (½)
- If the report is longer than 4 pages then an executive summary is necessary (1)
- Findings should be rated with higher rated findings occurring in the front of the report while other less important findings in an appendix (1)

(Marks as indicated. Maximum 5 marks)