

AUI3701

May/June 2016

THE INTERNAL AUDIT PROCESS: PLANNING THE ENGAGEMENT

Duration 2 Hours

100 Marks

EXAMINERS :

FIRST

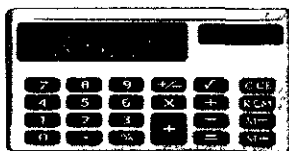
MR BL SHABANGU

SECOND

MRS BM VAN WYK

Use of a non-programmable pocket calculator is permissible.

Closed book examination.

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THIS PAPER CONSISTS OF **TEN (10)** PAGES

QUESTION	TOPIC	MARKS
1	Multiple-choice questions	24
2	Weaknesses and preliminary survey and interviewing	16
3	IPPF	24
4	Computer auditing terminology	16
5	Internal audit's role in ERM	20
Total		100

NOTE:

Although the primary purpose of the examination is to test your knowledge and application of the subject matter, your ability to organise and present such knowledge in written language of an acceptable standard will be taken into consideration by the examiners

[TURN OVER]

QUESTION 1

24 marks

REQUIRED

For each subsection of this question, select only the **one** alternative that you consider to be the most appropriate answer. Write down the number of the subsection and the letter preceding the selected alternative. Answer the subsections of this question in numerical sequence. For example

1.1 A

1.2 B

Each question counts 1½ marks

1.1 Which of the following activities falls outside the scope of internal auditing?

- A evaluating risk exposures regarding compliance with policies, procedures and contracts
- B evaluating risk exposures regarding compliance with laws and regulations
- C safeguarding of assets
- D ascertaining the extent to which management has established criteria to determine whether objectives have been accomplished

1.2 Of the three primary forms of control self-assessment (CSA) programs, which one is designed to gather information from a work team representing different levels in the business units or function?

- A auditor-produced analysis
- B surveys
- C management produced analysis
- D facilitated team workshops

1.3 Senior management of an entity has requested that the internal audit activity provide ongoing internal control training for all managerial personnel. This is best addressed by a(n)

- A informal consulting engagement agreement
- B special consulting engagement agreement
- C emergency consulting engagement agreement

[TURN OVER]

- D formal consulting engagement agreement
- 1.4 The primary difference between operational engagements and financial engagements is that, in the former, the internal auditors .
- A are seeking to help management use resources in the most effective manner possible
- B start with the financial statements of the client entity and work backward to the basic processes involved in producing them
- C can use analytical skills and tools that are not necessary in financial engagements
- D are not concerned with whether the client entity is generating information in compliance with financial accounting standards
- 1.5 Which financial ratio can you use during the preliminary survey to assist you to measure the long-term solvency of an organisation?
- A gross profit margin
- B debt to assets ratio
- C accounts receivables turnover rate
- D current asset ratio
- 1.6 A determination of cost savings is most likely to be an objective of a(n)
- A operational audit
- B financial audit
- C programme-results audit
- D compliance audit
- 1.7 Analytical procedures can be best categorised as
- A budget comparisons
- B tests of controls

[TURN OVER]

- C qualitative tests
- D substantive tests

1.8 Which one of the following is an appropriate internal audit objective?

- A To observe the physical inventory count
- B To determine whether inventory on hand is sufficient to meet the projected sales targets
- C To search for the existence of obsolete inventory by computing inventory turnover by product line.
- D To examine a sample of purchase orders and their corresponding purchase requisition for proper approval signatures

1.9 The internal auditor wants to understand the actual flow of data regarding cash processing. The most convincing information is obtained by

- A performing a walkthrough of the processing and obtaining copies of all documents used
- B reviewing the systems flowchart
- C reviewing the programming flowchart for information about control procedures placed into the computer programs
- D interviewing the treasurer

1.10 Interviewing operating personnel, identifying the objectives of the auditee, identifying standards used to evaluate performance and assessing the risk inherent in the auditee's operations are activities typically performed in which phase of an internal audit?

- A the reporting phase
- B the fieldwork phase
- C the audit programming phase
- D the preliminary survey phase

[TURN OVER]

- 1.11 The risk of a fuel tanker exploding while transporting fuel to filling stations will most likely be regarded as
- A an audit risk associated with fuel transportation
 - B a risk that will not be covered by any insurance policy
 - C an inherent risk associated with fuel transportation
 - D a control risk associated with fuel transportation
- 1.12 The scope of an internal audit is initially defined by the
- A audit programme.
 - B audit objectives
 - C scheduling and time estimates
 - D preliminary survey
- 1.13 The International Professional Practices Framework (IPPF) states that the main reason for an internal auditor evaluating the adequacy of the organisation's system of internal controls is to determine
- A the nature, extent and timing of the audit procedures
 - B the extent of compliance with key controls
 - C whether the control system is designed to help ensure the achievement of organisational objectives
 - D whether the internal control system adequately safeguards the organisation against material irregularities
- 1.14 Choose the **incorrect** statement from the alternatives below
- A An advantage of auditing around the computer is that the client's data will not be corrupted by the auditor
 - B A disadvantage of auditing through the computer is that audit costs may increase due to the level of investment in technology and expertise required

[TURN OVER]

- C An advantage of auditing around the computer is that computer systems can generally handle large volumes of data and transactions, which makes manual testing more effective
 - D The main advantage of auditing with the computer is that use is made of the power, speed and versatility of the computer, which results in a more efficient audit
- 1.15 An assurance engagement in the quality control department is being planned. Which of the following is **least** likely to be used in the preparation of a preliminary survey questionnaire?
- A the permanent engagement file
 - B management's charter for the quality control department
 - C the prior engagement communications
 - D an analysis of quality control documents
- 1.16 An internal auditor plans to review the adequacy of existing policies and procedures concerning end-user computing activities. The internal auditor will be testing
- A a systems control
 - B an organisational control
 - C an application control
 - D an environmental control

QUESTION 2

16 marks

Electro (Pty) Ltd entered into a cost-plus-a-fee contract with Ukwakha Construction (the contractor) to build a multipurpose processing plant adjacent to the main manufacturing plant.

The contractor has to provide and furnish all personnel, services, all materials and equipment required to build the plant. The contract includes a clause which allows Electro (Pty) Ltd to audit any of the processes associated with the cost-plus-fee contract.

At the close of each calendar month, the contractor submits an invoice covering 100% of all costs incurred.

[TURN OVER]

One month into the contract the executive management of Electro (Pty) Ltd requests the internal audit department to perform an internal audit review of the labour and payroll activities of the contractor. The reason for the internal audit review is that the contractor has been appointed on a cost-plus-fee contract.

As an internal auditor employed by Electro (Pty) Ltd and assigned to the internal audit, you observe the following in respect of labour:

Workers coming to the construction site each morning sign a log kept at the timekeepers' office on the project site. The contractor explains that each worker completes a daily time report, which is submitted to the payroll clerk in the field office at the end of each week. The payroll clerk then summarises the daily time reports. At this time, the foreman and the supervisor sign the summary, which is forwarded to the home office for processing.

The home office returns the payroll register along with the pay packets to the payroll clerk. On payday, the payroll clerk distributes the pay packets to the workers. The payroll clerk takes any uncollected pay packets home with him and returns them to the home office on the next working day.

REQUIRED

MARKS

- | | | |
|------------|----------------------------------------------------------------------------------------------------------------------------------------------------|-------------|
| 2.1 | Identify the weaknesses in the above payroll system | (10) |
| 2.2 | List potential sources of information that process owners have available that will help the internal auditor understand the process being audited? | (6) |

QUESTION 3

24 marks

As an internal audit student you are aware that the International Professional Practice Framework for Internal Auditors consists of three components (the definition of internal auditing, the Code of Ethics, and the International Standards for the Professional Practice of Internal Auditing).

REQUIRED

Consider the independent scenarios that follow below. For each of the scenarios, indicate and name the components and/or codes that have been violated. Support your answer by explaining the violation and indicating the requirements that should have been met.

[TURN OVER]

Structure your answer as follows

Permissible or not (1 mark)	Reference to Professional practice requirements (2 marks)	Reason (1 mark)
e.g. Code – Objectivity or Standard 1000 – Purpose, Authority & Responsibility		

REQUIRED

MARKS

- 3.1** Peter Brown is a newly appointed internal auditor at Arthur and Sons Accountants and Auditors. During the preliminary review for an audit at one of the company's key clients, Peter discovers a fraudulent transaction that implicates the Chief Executive Officer (CEO) of the company. He raises the matter with the audit manager for direction. Excited about his discovery, Peter informs family and friends about what has transpired and tells them that the CEO may also go to jail. **(4)**
- 3.2** Matthew, who is an internal audit manager with a company, is planning an audit of the debtors section. Matthew has been involved with the client for five years and has established a good relationship with the key personnel. During an interview, the Chief Financial Officer (CFO) informs George that he has been instructed to manipulate the debtors figure for the interim financial reports in an effort to improve the company's performance. Matthew does not report the matter, because he has been promised a performance bonus of R10 000. **(4)**
- 3.3** The external auditors complain that Mrs Schutte, who has recently been appointed as the Chief Audit Executive (CAE), does not want to share information with them regarding the audits performed by the internal audit activity during the recent year. **(4)**
- 3.4** Frans Khumalo, an internal audit manager, has been assigned to the planning of an audit at a department that is headed by his wife. **(4)**
- 3.5** John has just been appointed as an internal auditor at Moonlight (Pty) Ltd. When he asks the Chief Audit Executive about the internal audit charter, the CAE informs John that he does not see the need for an internal audit charter as every staff member has a job description. The CAE informs John that he has been the CAE for five years and although they never had a charter, the internal **(4)**

[TURN OVER]

audit activity has always been able to deliver according to the audit plan

- 3.6** An internal audit manager informs you that he sees no need to know about the company's risk assessment. He further explains that the internal audit engagements are very simple, because they audit only the financial systems. Only if they have enough time left thereafter, do they perform other types of audits. However, they are not compelled to do this **(4)**

QUESTION 4

16 marks

A computer environment has a unique "language". To be able to audit in such an environment, the auditor must have an understanding of that language. The following terms are frequently used and must be clearly understood:

- 4.1 Hardware
- 4.2 Application software
- 4.3 Back-up
- 4.4 Control totals
- 4.5 Masterfile
- 4.6 Database
- 4.7 Limit check
- 4.8 CAAT's

REQUIRED

In your own words, briefly explain each of the terms listed above (2 marks each)

QUESTION 5

20 marks

You are an internal auditor at Genkin Industrial Solutions (GIS), an engineering and construction company based in South Africa, but with operations throughout Africa. The company's head office is in Sandton, where most of the administration is done and where the internal audit activity is located. GIS also has a design office in Rustenburg, an office in Cape Town and two satellite offices in Windhoek and Gaborone. The company's staff consists of just over 2 000 people, most of whom are engineers and technicians, employed on a contract basis.

[TURN OVER]

The chairman of the audit committee is Mr Wessels. He has invited the internal audit team to join him and the other audit committee members for lunch. You have learned that Mr Wessels is a qualified chartered accountant and certified internal auditor, who used to be a CAE at a listed company before his retirement. On your way to the lunch, Mr Wessels remarks that he is looking forward to the value added by the internal audit activity and suggests that control/risk self-assessment should be used to foster control awareness throughout the company. During lunch the other two audit committee members also mention that they are keen to promote company-wide risk management (ERM) and expect the internal audit activity to follow a risk-based approach.

The ERM activities are as follows:

- giving assurance on the risk management processes
- coaching management in responding to risks
- developing ERM strategy for board approval
- accountability for risk management
- implementing risk response on management's behalf
- evaluating the reporting of key risks
- facilitating identification and evaluation of risks
- imposing risk management processes
- setting the risk appetite
- coordinating ERM activities

The CAE wants to know whether your internal auditing studies have shed any light on control self-assessment and enterprise-wide risk management.

REQUIRED	MARKS
5.1 Define ERM and explain five (5) benefits to GIS that will arise from implementing ERM in the company	(10)
5.2 Classify each of the above-mentioned ERM activities, as one of the following <ul style="list-style-type: none">• core internal audit roles, or• legitimate internal audit roles with safeguards, or• roles internal auditing should not undertake	(10)