

AUI3701

May/June 2017

THE INTERNAL AUDIT PROCESS: PLANNING THE ENGAGEMENT

Duration 2 Hours

100 Marks

EXAMINERS :

FIRST

SECOND

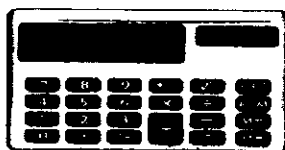
MRS BM VAN WYK

MS M EDWARDS

Use of a non-programmable pocket calculator is permissible

Closed book examination.

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THIS PAPER CONSISTS OF **SEVEN (7)** PAGES

QUESTION	MAIN TOPIC	MARKS
1	Multiple-choice questions	15
2	Code of Ethics	12
3	Risk management	32
4	Preliminary review, ratios and analytical procedures	25
5	Planning an assurance engagement	<u>16</u>
		<u>100</u>

NOTE

Although the primary purpose of the examination is to test the candidate's knowledge and ability to apply the subject matter, the examiners will also take into consideration his or her ability to organise and present this 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 alternative. Then write down, as your answer, the number of the subsection and the letter that precedes your 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 An internal auditor provides income tax services during the tax season. For which of the following activities would the auditor most likely be considered in violation of the IIA's Code of Ethics?

- A. preparing, for a fee, a division manager's personal tax returns
- B. appearing on a local radio show to discuss retirement planning and tax issues
- C. receiving a stipend for teaching an evening tax class at the local junior college
- D. working on weekends for a friend who has a small accounting firm

1.2 In which of the following situations does the internal auditor potentially lack objectivity?

- A. A payroll accounting employee assists an internal auditor in verifying the physical inventory of small motors
- B. An internal auditor discusses a significant issue with the senior manager whom the auditee reports to prior to drafting the audit report
- C. An internal auditor recommends standards of control and performance measures for a contract with a service organisation, for the processing of payroll and employee benefits
- D. A former purchasing assistant performs a review of internal controls over purchasing four months after being transferred to the internal audit department

1.3 Which one of the following is required of the internal audit function as per the IIA Standards?

- A. Annually evaluate annually the effectiveness of the audit committee
- B. Issue annually an overall opinion on the adequacy of the organisation's system of internal controls
- C. Obtain an annual representation from management acknowledging management's responsibility for the design and implementation of internal controls to prevent illegal acts

[TURN OVER]

- D. Access whether the information technology governance of the organisation sustains and supports the organisation's strategies and objectives

1.4 While planning an assurance engagement, the internal auditor obtains knowledge about the auditee's operations to, among other things

- A. develop an attitude of professional skepticism concerning management's assertions
- B. make constructive suggestions to management regarding internal control improvements
- C. evaluate whether misstatement in the auditee's performance reports should be communicated to senior management and the audit committee
- D. develop an understanding of the auditee's objectives, risks and controls

1.5 Who is responsible for establishing the *strategic* objectives of an organisation?

- A. The board of directors
- B. Senior management
- C. Consensus among all levels of management
- D. The board and senior management jointly

1.6 Which of the following is not an example of a risk-sharing strategy?

- A. Outsourcing a noncore, high-risk area
- B. Selling a nonstrategic business unit
- C. Hedging against interest rate fluctuations
- D. Buying an insurance policy to protect against adverse weather

1.7 Which one of the following provides the **best** reason for the chief audit executive to consider the organisation's strategic plan in developing the annual internal audit plan?

- A. To emphasize the importance of the internal audit function to the organisation
- B. To ensure that the internal audit plan will be approved by senior management
- C. To make recommendations to improve the strategic plan
- D. To ensure that the internal audit plan supports the overall business objectives

- 1.8 The possibility of someone maliciously shutting down an information system is most directly an element of
- A. availability risk
 - B. access risk
 - C. confidentiality risk
 - D. deployment risk
- 1.9 Recommendations should be included in the final audit communications to
- A. provide management with options for addressing audit observations
 - B. ensure that problems are resolved in the manner suggested by the auditor
 - C. minimize the amount of time required to correct audit observations
 - D. guarantee that audit observations are addressed, regardless of cost
- 1.10 Internal audit reports can be structured to motivate management to correct deficiencies Which one of the following report-writing techniques is most likely to be effective?
- A. State the procedural inadequacies and resulting improprieties in specific terms
 - B. Recommend changes and state the punitive measures that will follow if the recommendations are not implemented
 - C. List the deficiencies found so as to provide an easy-to-follow checklist
 - D. Suggest practical improvements to address the identified observations

QUESTION 2

12 marks

CIA's are often faced with situations which may involve ethical considerations Consider the following scenarios, where all the auditors referred to, have achieved the Certified Internal Auditor (CIA) status

- 1 Auditor A has not participated in any type of professional development activity for the last 3 years because the organisation he works for does not pay his membership fees to the Institute of Internal Auditors (3)
- 2 During his vacation, Auditor B prepared and presented an in-house training session for the internal audit activity of a customer of the company for which he is working He received a small amount as gratuity (3)
- 3 Auditor C has been assigned to an audit team working on an audit doing a risk-assessment for the acquisition of new computer equipment His spouse is a partner in the computer company tendering for supplying the new equipment (3)

[TURN OVER]

- 4 Auditor D was experiencing difficulties in doing his current audits as the organisation he was working for was becoming entirely computerised. He enrolled for a computer course four years earlier but due to his workload had to cancel it, and did not attempt the course again (3)

REQUIRED

For each of the above scenarios, state whether or not the condition is a violation of the Code of Ethics, and justify your answer in each case. Where appropriate, suggest a course of action for the auditor that would avoid any violation of the Code of Ethics.

QUESTION 3

32 marks

Part A

Ponies Ltd is a company that manufactures and sells horse-riding equipment, horse medication and vaccines. The company has been in business for many years and has an established customer base. The company imports most of its medical products and vaccines.

You are the newly employed internal audit director tasked by the audit committee to perform a risk assessment of the organisation, as the consultants who was previously responsible for performing the risk assessment is no longer in business. The chief audit executive (CAE) mentioned that you should consider using control risk self-assessment (CRSA) to assist you in compiling the risk assessment but you are not certain whether CRSA can be used in an environment such as Ponies Ltd.

REQUIRED

Marks

- | | | |
|-----|---|-----|
| 3.1 | Discuss the fundamental points embedded in the Committee of Sponsoring Organisations of the Treadway Commission's (COSO's) definition of risk | (2) |
| 3.2 | Discuss the reasons why it is important to implement CRSA as part of the risk management process at Ponies Ltd | (5) |

Part B

Through the CRSA process the following information came to light:

- One of the types of racing bridles manufactured and sold by the company has been declared illegal because it can damage the horse's jaw.
- The company discontinued its policy of sales for cash. All sales are on credit to account holders or by credit card to non-account holders.
- In an effort to boost sales, the company relaxed certain of its credit limits sometime during the past year.

[TURN OVER]

- Ponies Ltd is currently being sued by a horse breeder. The breeder claims that vaccine purchased from the company lead to the death of three horses. The total value of the claim is R250 000,00
- Imported veterinary products are regulated by the Veterinary Council of South Africa. Strict regulations apply with which companies must comply
- The chief financial officer (CFO) of Ponies Ltd is a certified internal auditor (CIA). As part of his duties, the CFO signed a contract to procure a large order from the supplier with the best price, quality and performance. Shortly after signing the contract, the supplier presented the CFO with a gift of significant monetary value which he accepted

REQUIRED

Marks

- 3.3** Identify the risks you would consider in compiling the risk assessment for Ponies Ltd (15)
- 3.4** Discuss whether the chief financial officer is guilty of non-compliance with the International Professional Practices Framework (IPPF) in relation to the Code of Ethics. (5)
- 3.5** Discuss the presentation process you would follow in compiling the presentation to be made to management to present the results from the risk assessment (5)

QUESTION 4

25 marks

Dirty Jobs Limited is a plumbing company that manufactures and sells plumbing supplies and provides plumbing services. You have been a senior internal auditor at the company from the inception of the internal audit activity, five years ago.

You have been assigned to assist with the internal audit of the sales and debtors' accounts for the months of January, February and March. You are only standing in for a colleague who has been admitted to hospital after being injured in a motor vehicle accident. The following is a summary of the budgeted and actual sales for three (3) months from a previous internal audit of the sales and debtors' accounts.

Month	Budget sales	Actual sales
January	R450 000	R260 000
February	R450 000	R560 000
March	R450 000	R380 000

[TURN OVER]

The sales manager also asked you to assist him with an evaluation of the financial soundness of the company, based on the financial statements of Dirty Jobs Limited for the most recent financial year

From the statements you determine that the current ratio was 2.8 compared with 1.9 in the previous financial year and an increase in the net operating loss was reported for the current financial year

REQUIRED

Marks

- | | | |
|-----|--|-----|
| 4.1 | Describe the additional information you would need to collect during your preliminary survey to enable you to perform the internal audit of the sales transactions | (8) |
| 4.2 | Compile six (6) analytical review procedures to test the reasonableness of the sales figures for January, February and March | (9) |
| 4.3 | Explain why the increase in the current ratio is unexpected | (3) |
| 4.4 | List two (2) possible causes that may account for the increase in the current ratio | (2) |
| 4.5 | Explain why the acid test ratio may be better than the current ratio as a measure of Dirty Jobs Limited's ability to pay for purchases as the accounts become due | (3) |

QUESTION 5

16 marks

Modern internal auditors can hardly think of conducting internal audit engagements without using the computer. Computer-assisted audit techniques have become an integral part of every phase of the internal audit engagement.

REQUIRED

Mention the steps that internal auditors should follow in planning an assurance engagement and for each step, describe how the internal auditor can make use of the computer in conducting that step. (16)

Please make use of the following format in your answer

Steps in the planning phase of an assurance engagement	Use of a computer in performing each step
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