

Tutorial Letter 202/1/2018

The Internal Audit Process: Planning the engagement

AUI3701

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 results 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: AUI3701

2 KEY TO ASSIGNMENT 02/2018 (FIRST SEMESTER)

Note the following in the comments below:

The **Standards** refers to the International Standards for the Professional Practice of Internal Auditing

CAE stands for the chief audit executive

IAA stands for the internal audit activity

Question	Correct answer	Study guide reference
1.1	1	Learning unit 11.2
<p>Option 1 is correct. Analytical audit procedures provide internal auditors with efficient and effective means of assessing and evaluating information collected in an engagement. The assessment is a result of a comparison between the information and the expectations identified or developed by the internal auditor. This information is useful in identifying, among other things, differences that are not expected, the absence of differences when they are expected, potential errors, potential irregularities or illegal acts or other unusual or non-recurring transactions or events (Practice Advisory 2320-1). Since analytical procedures are used to substantiate figures and presumptions, they can be regarded as substantive tests.</p> <p>Option 2 is incorrect because tests of control are used to evaluate the design, implementation and effectiveness of control activities.</p> <p>Option 3 is incorrect because budget comparison is one of many types of analytical procedures.</p> <p>Option 4 is incorrect because analytical procedures tend to be quantitative even when non-financial information is considered.</p>		
Question	Correct answer	Study guide reference
1.2	4	Learning unit 11.2
<p>Option 4 is correct. Inventory turnover provides analytical information. It equals cost of sales divided by average inventory. A low turnover ratio implies that inventory is excessive, for example, because the goods are obsolete or because the organisation has overestimated demand.</p> <p>Option 1,2 and 3 is correct, but only part of the complete answer.</p>		
Question	Correct answer	Study guide reference

1.3	4	Learning unit 11.1
<p>Option 4 is correct. An internal control questionnaire consists of a series of questions about the organisation's controls designed to prevent or detect errors of fraud. Answers to the questions help the internal auditor to identify specific controls relevant to specific assertions and to design tests of controls to evaluate the effectiveness of their design and operation.</p> <p>Option 1 is incorrect. The questionnaire is a tool to help understand and document internal control but is not sufficient as the sole source of information to support the assessment of control risk.</p> <p>Option 2 is incorrect. The internal control questionnaire must be designed to achieve the engagement objectives.</p> <p>Option 3 is incorrect. Yes/no question formats and question sequence by department may facilitate administering the questionnaire but other formats and methods of question organisations are possible.</p>		
Question	Correct answer	Study guide reference
1.4	2	Learning unit 11.1
<p>Option 2 is correct. An internal control questionnaire is used to identify possible problems in the internal control environment. It does not provide evidence thereof.</p> <p>Options 1 is incorrect. An internal control questionnaire does not provide evidence.</p> <p>Options 3 is incorrect. The questionnaire is sent to the auditee for completion. The auditor does not need to be in present.</p> <p>Option 4 is incorrect. The questionnaire does not necessarily take less time than other control evaluation devices.</p>		
Question	Correct answer	Study guide reference
1.5	4	Learning unit 11.2
<p>Option 4 is correct.</p> <p>Option 1, 2 and 3 is incorrect.</p>		
Question	Correct answer	Study guide reference

1.6	1	Learning unit 11.2
<p>Option 1 is correct. Analytical auditing procedures provide internal auditors with a efficient and effective means of assessing and evaluating information collected in an engagement. The assessment results from comparing information with expectations identified or developed by the internal auditor. Analytical auditing procedures are useful in identifying, among other things, differences that are not expected, the absence of differences when they are expected, potential errors, potential irregularities or illegal acts, or other unusual or nonrecurring transactions or events. (PA 2320-1). Thus, a comparison of current-period information with budgets or previous-period information is helpful in planning the engagement. This comparison may identify conditions, such as unreasonable amounts in financial statement, that may require subsequent engagement procedures.</p> <p>Option 2 is incorrect. Analytical procedures detect unreasonable amounts, not the specific causes of unexpected conditions.</p> <p>Option 3 is incorrect. Analytical procedures concern interrelationships among data, not the propriety of disclosure.</p> <p>Option 4 is incorrect. Analytical procedures are concerned with overall reasonableness, not the existence of specific errors.</p>		
Question	Correct answer	Study guide reference
1.7	1	Learning unit 14
<p>Option 1 is correct.</p> <p>Option 2, 3 and 4 is incorrect, because it all relates to the audit on wages and the question was which of the following does not....</p>		
Question	Correct answer	Study guide reference
1.8	3	Learning unit 6.3
<p>Option 3 is correct. Analytical procedures usually involve summarising and comparing data so that trends and other important relationships may be detected. The use of analytical procedures involves judgment and focuses on the overall reasonableness of recorded amounts. Thus, these procedures provide information that all transactions that should be presented are included (completeness).</p> <p>Option 1 is incorrect. Although relevant, analytical information is not direct. It is a means of gathering information without testing particular transactions directly.</p> <p>Option 2 is incorrect. Analytical information involves a study of plausible relationships</p>		

among data. Confirmation is a substantive test of details.

Option 4 is incorrect. For assertions of low materiality, analytical information may be considered sufficient.

Question	Correct answer	Study guide reference
1.9	1	Learning unit 10

Option 1 is correct. A control is any action taken by management, the board, or other parties to manage risk and increase the likelihood that established objectives will be achieved. Management plans, organises, and directs the performance of sufficient actions to provide reasonable assurance that objectives will be achieved. Thus, control by management is the result of proper planning, organising and directing.

Option 2 is incorrect. Ascertaining needs, identifying alternative courses of action, setting standards for measuring performance, and comparing outcomes with predetermined standards is a basic management function.

Option 3 is incorrect. Authorising and monitoring performance and comparing actual performance with planned performance is a basic management function.

Option 4 is incorrect. Determining efficiency and economy of operations, including whether objectives have been met is a basic management function.

Question	Correct answer	Study guide reference
1.10	2	Learning unit 10

Option 2 is correct. Risk management, control and governance processes are effective if management directs processes to provide reasonable assurance of achieving the organisation's objectives. In addition to accomplishing the objectives and planned activities, management directs by authorising activities and transactions, monitoring resulting performance and verifying that the organisation's processes are operating as designed.

Option 1 is incorrect. The adequacy of risk management processes concerns planning and design by management that provides reasonable assurance that objectives will be achieved efficiently and economically.

Option 3 is incorrect. The adequacy of risk management processes concerns planning and design by management that provides reasonable assurance that objectives will be achieved efficiently and economically.

Option 4 is incorrect. The adequacy of risk management processes concerns planning

and design by management that provides reasonable assurance that objectives will be achieved efficiently and economically.

Question	Correct answer	Study guide reference
1.11	2	Learning unit 11.1

Option 2 is correct. Internal auditors conduct a survey to (1) become familiar with activities, risks and controls to identify areas for engagement emphasis and (2) invite comments and suggestions from clients (PA 2210.A1-1, para. 3). An analysis of quality control documents is a part of field work, which follows the survey.

Option 1 is incorrect. The permanent engagement file probably contains information, such as problems detected in prior years that will help in the development of appropriate questions to ask this year.

Option 3 is incorrect. The prior engagement communications will likely assist in developing the current year's questionnaire.

Option 4 is incorrect. Knowing what the department is supposed to do will help the internal auditor develop knowledgeable questions.

Question	Correct answer	Study guide reference
1.12	1	Learning unit 14

Option 1 is correct. According to Standard 2220, "The established scope should be sufficient to satisfy the objectives of the engagement." Moreover, according to PA 2210-1, "Planning should be documented. Engagement objectives are road statements developed by internal auditors and define what the engagement is intended to accomplish. Engagement procedures are the means to attain engagement objectives and procedures, taken together, define the scope of the internal auditor's work."

Option 2 is incorrect. The scheduling and time estimates are based on the objectives and scope of the engagement.

Option 3 is incorrect. The preliminary survey is performed before the objectives are determined, but the objectives and procedures define the scope of the engagement.

Option 4 is incorrect. The work program is developed after the preliminary survey and is based on the objectives of the engagement.

(1½ marks)

Question 2**30 Marks****2.1 Risks****Reference: Study Unit 3.1.2**

1. This control is intended to reduce the risk of unauthorised employees entering the warehouse and will be part of the controls designed to protect the company's inventory from theft or damage.
2. This control procedure is implemented to reduce risk of the company's cash (asset) being stolen or used for invalid purposes. To reduce the risk of invalid payments.
3. This control procedure is implemented to address the risk of the non-creditworthy customers being given credit, leading to the company suffering loss because a customer to whom credit terms were extended, does not pay for goods purchased from Brightlights (Pty) Ltd.
4. This control is to identify differences between actual inventory (physical) and recorded inventory, which can then be followed up to ascertain the reason for the difference.
 - a) It is one of the controls used to address the risk theft of inventory or misallocation of inventory (placed in incorrect location).
 - b) It also contributes to address risk of inaccurate perpetual inventory records as differences may be caused by problems in the recording of inventory.
5. There are a number of internal controls covered here and the overall intention is to address the risk of unauthorised masterfile amendments being put through (usually) to cover up shortages in inventory brought about by theft. There are also some lesser risks addressed.
 - a) Sequenced hardcopy masterfile amendment forms (MAF) provide each document with a unique number. This allows for subsequent follow up and reduces the risk of an incomplete or inaccurate inventory masterfile as MAF could be lost or not entered.
 - b) Having the financial accountant sign after checking the supporting document reduces the risk of unauthorised, inaccurate or incomplete adjustments being made to the records.
6. This internal control is intended to reduce the risk of a dispatch of goods to a customer not being raised as a sale and thus resulting in a loss to Brightlights (Pty) Ltd.
7. Having the credit note cross-referenced to the original sale and presented with the goods returned note and supporting documentation enables the accountant to reduce risk of invalid or inaccurate credit notes being processed.

(1½ mark for each valid risk, maximum 12 marks)

2.2 Sources of information from process owners**Reference: Study Unit 5.1**

- Policies relating to the process (1)
- Procedure manuals (1)
- Organisational charts or similar information outlining the number of employees and key reporting relationships (1)
- Job descriptions for people involved in the process (1)
- Process maps or flowcharts depicting the overall flow of the process (1)
- Narrative descriptions of key tasks or portions of the process (1)
- Copies of key contracts with customers, vendors, outsourcing partners, et cetera (1)
- Relevant information regarding laws and regulations affecting the process (1)

- Other documentation that may have been developed to support required reporting on the effectiveness of the system of internal controls (1)

(Maximum of 6 marks)

2.3 Proper interviewing skills

Reference: Study Unit 5.3

No.	Stage contravened	Guidance for correcting the shortcomings
a	Preparing for the interview	A prerequisite for a successful interview is proper preparation. Auditors must work through all the documentation at their disposal before the commencement of an interview and should not ask questions during an interview if they should have known the answers from their study of the documentation.
		<p>The trainees should study organisational documentation which is available on the intranet and in the permanent internal auditing files. This may include all or some of the following:</p> <ul style="list-style-type: none"> • Policies and Procedures. • Operating manuals. • Organisation charts and functional job descriptions. • Legislation: laws, charters and ordinances. • Reports: internal and external. • Prior audit reports. • Working papers. • Technical journals.
b	Scheduling the interview	The first step to a successful interview is to arrange the meeting. A suitable time and place should be arranged beforehand for the meeting, and surprise visits should be limited to those areas in which they are absolutely imperative.
		<p>Piet should in future:</p> <ul style="list-style-type: none"> • Make the arrangements in advance. • Arrange suitable hours and days. • Share the agenda and request materials prior to the meeting.
c	Conducting the interview	<p><u>Taking notes</u></p> <p>Never record complete minutes, as it may adversely affect the other person and it is not conducive to good listening. The auditor will have to distinguish between material and immaterial items for recording.</p>

	Recording the interview	<ul style="list-style-type: none"> Review, organise and record your notes as soon as possible after the interview, at least on the same day. Write out enough, so that conclusions are reasonably self-explanatory. Send a copy of your notes to the interviewee for his or her review and agreement, where appropriate.
d	Closing the interview	Stick to the time schedule even if you have not finished your agenda; simply arrange for another meeting.
	Scheduling the interview	<p>A. Make advance arrangements</p> <ul style="list-style-type: none"> Time and place; auditee's work area most desirable. Probable duration of meeting; limit to an hour or less. <p>B. Arrange favourable hours and days</p> <ul style="list-style-type: none"> Avoid hours immediately before or after lunch.
	(1 mark each) (Maximum of 4 marks)	(2 marks each) (Maximum of 8 marks)

Question 3

Scenarios permissible or not according to IPPF

Reference: Study Unit 1

#	Permissible or not (1 mark)	Professional practice requirements (2 marks)	Reason (1 mark)
1	Not permissible (1)	<ul style="list-style-type: none"> IIA Code of Ethics Confidentiality (1) Internal auditors shall be prudent in the use and protection of information acquired in the course of their duties. (1) 	Peter Brown disclosed sensitive company information to family and friends and he did not have a legal obligation to do so. (1)
2	Not permissible (1)	<ul style="list-style-type: none"> IIA Code of Ethics - Integrity (1) Internal auditors shall not be a party to any illegal activity, or engage in acts that are discreditable to the profession of internal auditing, or to the organisation they work for. (1) 	Matthew, knowingly became engaged in an act that was discreditable to the profession by accepting an offer of R10 000.00 for not reporting the manipulated debtors figure. (1)

#	Permissible or not (1 mark)	Professional practice requirements (2 marks)	Reason (1 mark)
3	Not permissible (1)	<p>IIA Code of Ethics - Competency (1) Code of ethics 4.2: Internal auditors shall perform internal audit services in accordance with the International Standards for the Professional Practice of Internal Auditing. (1)</p> <p>IIA Standard 2050: Coordination (1) The chief audit executive should share information and coordinate activities with other internal and external providers of assurance and consulting services to ensure proper coverage and to minimize duplication of efforts. (1)</p>	<p>As CAE, Mrs Schutte should have a detailed knowledge of the internal auditing standards. She should therefore know that she needs to share information with the external auditors. (1)</p> <p>Standard 2050 requires internal auditors to share information with other assurance providers. The CAE should not refuse the external auditors access to information relating to audits conducted by the internal audit activity.</p>

Question 4

4. Terminology used in computer auditing

References:

- Study guide, section 3
- Jackson & Stent chapter 8
- Reding et al Chapter 7

4.1 Hardware

Computer hardware comprises the physical components of an information system. Hardware includes, for example central processing units (CPUs) servers, workstations and terminals, computer chips, input/output devices such as scanners and printers, storage devices such as disc drives and communication devices such as modems and routers.

4.2 Application software

Every laptop, desktop, mainframe and server computer contain different kinds of software that is required for the computer to function properly and make it user friendly. Application software enables end users to perform their assigned tasks. It includes accounting software that is used to process transactions as well as other types of software, such as word processing and spreadsheet software.

4.3 Back-up

Back-ups help in reconstructing systems or information that is lost or damaged. It is a process of making backups (copies) of all or parts of files, databases and programs that will

be needed in such a scenario.

4.4 Control totals

Control totals are used as input controls with batch processing. Source documents are grouped into separate batches of, say 50, and control totals are manually computed for each batch. When all records have been entered, the computer calculates its own control totals based on what has been keyed in and compares these totals to the manually computed totals calculated earlier. Control totals may either be financial totals (totals of any fields holding monetary amounts), hash totals (totals of any numeric fields eg. Invoice number) and/or record counts (the number of records in the batch, eg. 50 invoices).

4.5 Masterfile

Masterfiles contain crucial data used in computerised processing. In the HR department, for instance, the masterfile will contain the details of the employee, the appointment date, salary notch, rank in the organisation, qualifications and so on. Masterfile data needs to be protected from unauthorised change because such changes could cause serious trouble for organisations.

4.6 Database

A database is a pool of interrelated data, which is managed, structured and stored in such a way that -

- duplication of data is minimised,
- it contains all the necessary information needed to allow sharing of common data among different programs and users,
- the data is quickly accessible by all authorised users, and
- many users can access the same data simultaneously and will be provided with the same view of the data at any one time, in spite of any updates in progress.

4.7 Limit check

Limit checks are input controls which detect when a field entered does not satisfy a limit which has been set- for example, the normal hours worked by an employee in a week cannot be entered at a quantity greater than 40 hours.

4.8 CAATs

"CAATs" is the abbreviation used for the term "computer assisted audit techniques". The term refers to computerised techniques used by auditors to perform audits and in simple terms means making use of a computer to assist in carrying out an audit.

(2 marks per correct explanation; maximum 16 marks)

Question 5

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5.1 Steps in the internal audit process

Reference: Study guide: Learning unit 5

5.1.1 Nature of work 2100

The internal audit activity evaluates and contributes to the improvement of risk management, control and governance systems.

2110 --- Risk Management

The internal audit activity should assist the organization by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems.

2120 --- Control

The internal audit activity should assist the organization in maintaining effective controls by evaluating their effectiveness and efficiency and by promoting continuous improvement. (4)

5.1.2 Engagement planning

Standard 2200 --- Engagement Planning

Internal auditors should develop and record a plan for each engagement.

2201 --- Planning Considerations

In planning the engagement, internal auditors should consider:

- The objectives of the activity being reviewed and the means by which the activity controls its performance.
- The significant risks to the activity, its objectives, resources, and operations and the means by which the potential impact of risk is kept to an acceptable level.
- The adequacy and effectiveness of the activity's risk management and control systems compared to a relevant control framework or model.
- The opportunities for making significant improvements to the activity's risk management and control systems. (4)

5.1.3 Performing the engagement

Standard 2300

Internal auditors should identify, analyse, evaluate and record sufficient information to achieve the engagement's objectives.

2310 --- Identifying Information

Internal auditors should identify sufficient, reliable, relevant and useful information to achieve the engagement's objectives.

2330 --- Recording Information

Internal auditors should record relevant information to support the conclusions and engagement results. (4)

5.2 Determine the scope of an audit engagement

Reference: Study guide: Learning unit 13

The scope of an audit engagement refers specifically to the nature, timing and extent of audit procedures to be performed during the engagement.

- Nature (1) refers to the type of engagement (1) (compliance (½), performance (½) or environmental safety (½) evidence).
- Timing (1) refers to when the evidence will be gathered (evidence relating to the period between 1 January 20xx and 30 June 20xx) (1).
- Extent (1) refers to how much of what type of evidence to be gathered (oral (½), documentary, (½) or physical (½) evidence).

In view of restrictions in respect of the time and funds budgeted, internal auditors need to set specific limits for the scope of an audit. (1)

5.3 The steps that should be followed during a preliminary survey

Reference: Study guide: Learning unit 9

- An initial study should be conducted at the office of the internal audit activity to obtain as much information as possible on the operations of the auditee.(1)
- Documents (1) should be compiled to assist the internal auditor with the preliminary survey, and documents on the structure, regulations and operations of the auditee should be collected. Such documents may include the following:
 - Reminder lists should be compiled to guide the internal auditor during the execution of the preliminary survey. (1)
 - A draft set of working papers can be assembled in preparation for the internal audit. (1)
 - Questionnaires can be included, especially if the internal auditor plans to use control self-assessment methods during the performance of the engagement.(1)
 - The internal auditor will arrange an initial meeting with the auditee and prepare to interview key personnel to gain a better understanding of the operations of the auditee. (1)
- On completion of all the preparations, the internal auditor will commence gathering the required additional information on the structure, regulations and operations of the auditee. (1)
- It is necessary to consider the organisational objectives, (1) the objectives of the internal audit activity (1) and the impact of any regulatory requirements (1) and the Standards before the information collected during the preliminary survey can be used. (1) All of this information is used to decide on the internal audit objectives for the specific engagement in such a way that it will add value to and improve the organisation's operations.

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