

UNIVERSITY EXAMINATIONS



UNIVERSITEITSEKSAMENS

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AUI3702

October/November 2015

THE INTERNAL AUDIT PROCESS: TEST OF CONTROLS

Duration 2 Hours

100 Marks

EXAMINERS

FIRST

SECOND

MRS S JAFFER

MRS BM VAN WYK

Use of a non-programmable pocket calculator is permissible

Closed book examination

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THIS PAPER CONSISTS OF **NINE (9)** PAGES

Question	Main topic	Marks
1	Multiple-choice questions	15
2	Weaknesses and recommendations – revenue and receipts process	28
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4	Audit findings and audit working papers	14
5	Audit procedures – purchases and payments cycle	<u>20</u>
		<u>100</u>

Please 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 consider the candidate's ability to organise and present such knowledge in acceptable, written English

Question 1

Required:

For each subsection of this question, select only **one** alternative that you consider to be the most correct answer. Then, as your answer, write down the number of the subsection and the letter that indicates the alternative you have selected. Answer the subsections of this question in numerical order. For example

- 1.1 A
- 1.2 B

Each question counts 1½ marks

- 1 1 When testing controls, the internal auditor must be free from interference when determining the scope of such testing, the procedures and so on. In order to accomplish this, the internal auditor should report to levels in the organisation that allows it to accomplish its responsibilities. The best reporting structure for internal audit will be
- A functionally to the audit committee and administratively to the chief executive officer
 - B administratively to the audit committee and functionally to the chief executive officer
 - C functionally to the chief audit executive and administratively to the audit committee
 - D functionally to the audit committee and administratively to the chief audit executive
- 1 2 The requirement that purchases be made from suppliers on an approved vendor list is an example of a . control.
- A detective
 - B corrective
 - C preventative
 - D monitoring
- 1 3 The purpose of the combined assurance model is to provide a coordinated approach to all assurance activities that will optimise the assurance coverage obtained. A report from a regulator on management's internal processes can be regarded as assurance from

- A an internal assurance provider
 - B an external assurance provider
 - C. the management as an assurance provider
 - D. a first line of defence.
- 1 4 Residual risk can be defined as ..
- A the amount of risk an organisation is willing to accept in pursuit of its business objectives
 - B. the portion of risk that remains after management executes its risk responses
 - C. the acceptable levels of risk size and variation relative to the achievement of objectives
 - D the combination of internal and external risk factors in their pure, uncontrolled state, assuming there are no internal controls in place
- 1.5 During a review of the audit files, the senior internal auditor finds an audit file that contains an audit programme, specifically designed for an audit, where a third of the procedures have been left undone without any further explanation. This is a violation of which of the principles of the code of ethics?
- A Objectivity
 - B Integrity
 - C Confidentiality
 - D Competency
- 1 6 An internal auditor's procedure states the following "Inspect that invoices are numbered in sequence to confirm that all sales transactions are recorded" Which of the following assertions are being tested in the above audit procedure?
- A. Validity
 - B Completeness
 - C. Classification
 - D Authorisation
- 1 7 When selecting a sample, you have to determine the acceptable error rate Which of the following factors needs to be considered?

- A. Materiality
B. The purpose of the test
C. The effectiveness of the system of internal control
D All of the above
- 1 8 Which of the following procedures would provide the best evidence of the effectiveness of the credit granting function?
- A Observe the credit granting process
B. Ask the credit manager about the effectiveness of the function
C Review the trend in receivables write-offs
D Search for evidence of credit approval on a sample of customer orders.
- 1 9 A 90% confidence interval for the mean of a population based on the information in a sample always implies that there is a 90% chance that the
- A true population mean lies within the specified confidence interval
B. estimate is equal to the true population mean
C true population mean is no larger than the largest end point of the interval
D standard deviation will not be any greater than 10% of the population mean
- 1 10 During an audit of the receiving operations of a manufacturing organisation, an internal auditor will be most concerned with the risk that the function has
- A. received goods that were ordered
B failed to detect the receipt of substandard goods.
C accepted goods in excess of current needs
D. paid inflated prices for goods from related parties

Question 2

28 marks

You are an internal auditor at a clothing company, Woolgars Ltd. Recently, one of the auditors conducting the audit of the revenue and receipts cycle had resigned and you have now been assigned to the audit as his replacement. His interview notes were found in the audit file and contained the following information:

Order department

- Orders are received by the switchboard administrator either by telephone or by e-mail
- The switchboard administrator writes down all the telephonic orders on a piece

of paper and places it in a box to be sent to the warehouse clerk. All e-mail orders are printed and placed in the box with the paper noted telephone orders. Sometimes customers phone as well as e-mail their orders.

- The company only deals with credit sales as they do not want the risk of cash being on the premises. The switchboard administrator will check the system to see if the customer is an existing customer and will write the customer number down on the order. If the customer is not an existing customer, she will take down his or her details and create a customer number on the system.

Warehouse

- The pickers collect the box and pick the orders according to the piece of paper or email. If the item is not on stock, the picker scratches it out on the piece of paper or email.
- The picked goods are then sent to the warehouse foreman to prepare the delivery note. The warehouse clerk prepares the delivery note from the picking slip.

Despatch

- The despatch clerk receives the goods from the warehouse after it has been picked. Upon receipt of the goods, the despatch clerk signs the delivery note as proof. The despatch clerk prepares the delivery list accordingly.
- The goods are then placed into boxes and sealed. The address labels are previously printed out and placed on the box when it is sealed.
- The goods are left in a designated area while the despatch clerk is waiting for the truck driver. The area is marked off by a white painted line on the floor.
- The despatch clerk supervises the loading of the truck to ensure that all goods are placed on the truck.
- At the gate, the security guard takes down the truck driver's name and the truck's number plate to record people entering and leaving the premises.
- One copy of the delivery note is handed to the customer for their own reference purposes.

Required:

- 2.1 According to the standards, internal auditors must develop and document a plan for each engagement. What are the factors the auditor should consider when developing an engagement plan? (4)
- 2.2 Identify the weaknesses in the above revenue and receipts cycle (12)

2 3 Recommend a relevant internal control per identified weakness to mitigate the identified weaknesses (12)

Structure your answer in the following format.

2 2 Weaknesses	2 3 Controls

Question 3

23 marks

You are currently an internal auditor at a top auditing firm. You have been seconded to a company to assist the upcoming internal audit department with various queries that they might have when completing their respective audits. The following queries were received by you.

Query 1

Dear Auditor

I am at the beginning stages of an audit of the purchases and payments cycle. I have decided to use a statistical sampling method when choosing my sample. The receiving clerks have been specifically instructed to check the goods received, quantities, descriptions and the calculations on the goods received note before accepting any orders.

I have gathered the following information as well:

Population: 500 goods received notes

Confidence level: 90%

Precision limit: $\pm 4\%$

Acceptable error rate: 5%

Population size	Sample size for precision of		
	$\pm 2\%$	$\pm 3\%$	$\pm 4\%$
200		84	58
300	156	97	64
400	179	106	67
500	196	112	70
600	210	116	71
700	221	119	73

Population size	Sample size for precision of		
	±2%	±3%	±4%
800	230	122	74
900	237	124	74
1000	244	125	75

Required:

3 1 Name the three types of statistical sampling methods that can be used For the example in query 1 indicate which one you would use and why? (5)

3 2 What are the steps that you will follow to determine the number of items (sample size) that you will include in your sample? (7)

Query 2

Dear Auditor

I am currently in the process of performing ratio analysis on the financial statements I have obtained the following information:

Income statement for the year ended 31 March	2015	2014
	R' 000	R' 000
Credit sales	19 720	21 450
Cost of sales	15 187	16 130
Average inventory holding	1 108	1 306

The company's sales policy requires the gross profit percentage to be 24% of sales.

Required:

Marks

3 3 Calculate the following ratios for 2014 and 2015 **and** discuss how the results should be interpreted.

3 3 1 Inventory turnover ratio (5)

3 3 2 Gross profit ratio (6)

Question 4

14 marks

You have been assigned to conduct an internal audit of the payroll function at WeWantMoney Inc. The audit is reaching its end stage and you are now drafting your findings to present to the audit committee and management. You have noted the following information during the audit:

WeWantMoney Inc		ME
Internal audit working paper		
Internal audit of the payroll process		31 October 2015
Audit objective	Audit procedure	Results
To ensure that all overtime is approved by supervisor	Inspect timesheets of employees for supervisor's signature to ensure that all overtime is authorised	Time sheets were inspected and it was noted that the supervisor's signature was not visible. During a discussion with the supervisor, it was further noted that he does not have enough time as there are too many employees.
Conclusion:		
Overtime is not approved by the supervisor		

Required:

Marks

- | | | |
|-----|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------|
| 4.1 | Outline the working paper requirements as per the standards | (4) |
| 4.2 | Analyse the internal audit working paper and compile an internal audit finding based upon the requirements of the International Professional Practice Framework (IPPF) concerning audit findings | (10) |

Question 5

20 marks

You are a senior internal auditor at the ABC Limited. You are currently busy with an audit of the purchasing cycle. The following controls were noted by you during your walkthrough of the process:

- Orders are placed by the order clerks after they have received authorisation

from the relevant line managers

- The company implements a policy where three quotes must be obtained from suppliers before an order can be placed. The quote that is the cheapest will be selected.
- When the goods arrive, they are offloaded in the presence of the goods receiving clerk. The goods received clerk compares the order to the goods received note.
- The goods received clerk also physically inspects the goods received to make sure that goods are received in good condition.
- The goods receiving clerk signs the goods received notes once he or she is satisfied with the goods.
- The recording of purchases is conducted by the creditors recording function. Upon receipt of the invoice, the clerks match the invoice to the goods received note and the purchase order.
- Creditors are paid by cheque. The cheque requisitions are signed by two designated individuals.
- The supporting documentation is stamp-cancelled by the designated officials once the cheques are prepared.

Required:

20 marks

- 5.1 Identify the risks that each of the above controls are mitigating. (8)
- 5.2 Compile one test of control (audit procedures) to test the reliability of each of the controls identified in the above internal control questionnaire. (12)