

Tutorial Letter 201/2/2014

THE INTERNAL AUDIT PROCESS: TEST OF CONTROLS

AUI3702

Semester 2

Department of Auditing

This tutorial letter contains important information about your module.

Bar code

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1 BRIEFING

This assignment consisted of 20 multiple-choice questions which you had to answer on a mark-reading sheet. The assignment was marked electronically and you should have received a report on the mark you received for the assignment. We would now like to provide the correct answers to the various questions.

The mark you have received for this assignment will contribute towards your year mark, and your year mark will contribute 10% towards your final mark for this module.

We trust that you found this assignment interesting and challenging. We hope that you are looking forward to learning more about the practice of internal auditing in this module.

Lecturer: AUI3702

2 KEY TO ASSIGNMENT 01/2014 (SECOND SEMESTER)

Question	Correct answer	Study guide reference
1.1.	1	Study unit1.1
<p>Option 1 is correct. This scenario violates the integrity principle. According to IIA Code of Ethics, Rules of Conduct: integrity -“Internal auditors shall not knowingly be a party to any illegal activity, or engage in acts that are discreditable to the profession of internal auditing or to the organisation.”</p> <p>Option 2 is incorrect. This scenario violates the confidentiality principle. According to IIA Code of Ethics, Rules of Conduct: confidentiality -“Internal auditors shall be prudent in the use and protection of information acquired in the course of their duties.</p> <p>Option 3 is incorrect. This scenario violates the objectivity principle. According to IIA Code of Ethics, Rules of Conduct: objectivity -“Internal auditors shall not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. This participation includes those activities or relationships that may be in conflict with the interests of the organisation”.</p> <p>Option 4 is incorrect. This action is permissible and not a violation of the IIA Code of Ethics.</p>		
Question	Correct answer	Study guide reference
1.2.	1	Study unit 4.1.3
The calculation of the average collection period consists of the following variables:		

Average outstanding debtors and credit sales

An increase in the collection period can only be due to a decrease in credit sales or an increase in average outstanding debtors. Only option 1 would result in an increase in average outstanding debtors because more credit would be granted, possibly to debtors who would not be able to pay it back.

Question	Correct answer	Study guide reference
1.3.	2	Study units 1.1.3 and 2.1

Option 2 is correct. Due professional care implies reasonable care and competence, not infallibility or extraordinary performance. It requires the internal auditor to conduct examinations and verifications to a **reasonable** extent (PA 1220-1, para 2).

Option 1 is incorrect. Examinations and verification need only be undertaken to a reasonable extent.

Option 3 is incorrect. An internal auditor cannot give absolute assurance.

Option 4 is incorrect. The possibility of material irregularities must be considered.

Question	Correct answer	Study guide reference
1.4.	2	Study units 1.1.3 and 2.1

Option 2 is correct. Internal auditors must be alert to those conditions and activities where irregularities are most likely to occur and must identify inadequate controls. (PA 1220-1, para 1). Thus, the internal auditor did not exercise due professional care. Cash has a high degree of inherent risk and should therefore be subject to strict controls. Access to cash and the record-keeping functions should be separated regardless of the personal qualities of the individuals involved. The fact that the internal auditor trusts the clerk is irrelevant. Management still needs to be aware that internal control over receivables is inadequate.

Option 1 is incorrect. The auditor's engagement observation is inappropriate given the lack of segregation of functions.

Option 3 is incorrect. In this scenario, the alertness of the condition was shown by the auditor but he ignored it because he trusted the clerk.

Option 4 is incorrect. Annotation of the working papers does not indicate that the auditor exercised due professional care. Cash has a high inherent risk of irregularities and professional judgment and alertness are thus necessary.

Question	Correct answer	Study guide reference
1.5.	2	Study units 1.1.3 and 4.1
<p>Option 2 is correct. Internal auditors must ascertain the extent to which management has established adequate criteria to determine whether objectives and goals have been accomplished (IIA Standards 2210.A3).</p> <p>Option 1 is incorrect. Verifying existence relates to the safeguarding of assets.</p> <p>Option 3 is incorrect. The reliability of operating information concerns the reliability and integrity of information.</p> <p>Option 4 is incorrect. Verifying the accuracy of asset valuation concerns the reliability and integrity of information.</p>		
Question	Correct answer	Study guide reference
1.6.	3	Study unit 3
<p>Option 3 is correct. "The purpose of control processes is to support the organization in the management of risks and the achievement of its established and communicated objectives. The control processes are expected to ensure, among other things, that operations are performed efficiently and achieve established objectives". (PA 2130-1, para. 1).</p> <p>Option 1 is incorrect. Collusion is an inherent limitation of internal control.</p> <p>Option 2 is incorrect. Controls are actions by management, the board and others to manage risk and increase the likelihood that established goals and objectives will be achieved (IIA Glossary). The internal audit activity evaluates the effectiveness of controls processes (PA 2130-1). Thus, controls do not directly address management's planning, organising and directing processes. Internal auditors evaluate management's processes to determine whether reasonable assurance exists that objectives and goals will be achieved.</p> <p>Option 4 is incorrect. The board, and not the internal audit activity, provides oversight of risk management and controls processes administered by management.</p>		
Question	Correct answer	Study guide reference
1.7.	4	Study unit 7.2
<p>Option 4 is correct because it includes options 1 to 3. Acceptable industry standards</p>		

(option 2), standards developed by professions or association (option 1), standards in law and government regulations and other sound business practices (option 3) are usually deemed to be appropriate criteria.

Question	Correct answer	Study guide reference
1.8.	4	Study unit 2.1.1.3

Option 4 is correct because this is a responsibility of the internal audit function, **not** the audit committee.

Options 1 to 3 are incorrect as these are responsibilities of the audit committee.

Question	Correct answer	Study guide reference
1.9.	3	Study unit 2.1.1.3

Option 3 is correct as the risk management function is an internal assurance provider.

Options 1, 2 and 4 are incorrect as they are external assurance providers.

Question	Correct answer	Study guide reference
1.10.	3	Study unit 3.1.1

Option 3 is correct. This is the internal control principle of segregation of duties. An employee should not be responsible for incompatible duties. Only the goods receiving clerk has the responsibility to receive ordered goods and would therefore also be the best person to receive the defective merchandise.

Question	Correct answer	Study guide reference
1.11.	3	Study unit 4.2.2

Option 3 is correct because non sampling risk occurs when an internal auditor fails to perform his/her work correctly. An example of this risk would be the use of incorrect audit procedures.

Option 1 is correct. Alpha risk is the risk that the internal auditor will understate the reliance that management can place on the control to reduce residual risk to an acceptable low level.

Option 2 is incorrect. Sampling risk is the risk that the internal auditor's conclusion based on the sample testing, may have been different from the conclusion reached if

the audit procedure had been applied to all items in the population.

Option 4 is incorrect. Beta risk is the risk that the internal auditor will incorrectly conclude that a specified control is more effective than it really is.

Question	Correct answer	Study guide reference
1.12.	2	Study unit 4.2.2

Option 2 is correct. The inventory turnover rate indicates the extent to which inventory is sold or transferred into cash. An increase in the ratio means increases in the inventory sold and therefore fewer inventories on hand and a smaller likelihood of the inventory becoming obsolete. A decrease in the ratio means the inventory is not sold as quickly, increasing the likelihood of inventory becoming obsolete. The other options do not reflect on obsolete inventory.

Question	Correct answer	Study guide reference
1.13.	2	Study unit 3

Option 2 is correct. Separating the cash receipts and record-keeping functions prevents an employee from misappropriating cash and altering the records to conceal it.

Option 1 is incorrect as cash receipts may be physically safeguarded by such measures as a secure cash receiving point.

Option 3 is incorrect as cash receipts and disbursements functions should be separated in order to prevent paying cash disbursements directly from cash receipts.

Option 4 is incorrect as initial accountability may be fixed by issuing a source document when the cash is received.

Question	Correct answer	Study guide reference
1.14.	1	Study unit 3.1.1

Only option 1 is an internal control weakness. The weakness refers to proper segregation of duties. If the supervisor distributes the pay cheques and performs the other normal duties of a supervisor (give through the hours worked and manages changes in the staff employment), he/she could create possible ghost employees.

Question	Correct answer	Study guide reference
1.15	1	Study unit 3.1.1

Only option 1 is correct because the main aim of a system of internal control is to

ensure that systems operate as intended to ensure that objectives are achieved.		
Question	Correct answer	Study guide reference
1.16.	1	Study unit 3.1.1
Only option 1 is the internal audit objective. Options 2, 3 and 4 are audit procedures.		
Question	Correct answer	Study guide reference
1.17.	3	Study units 1.1.3 and 3.1.1
Option 3 is correct because the assurance function of internal auditors requires them to review systems. Options 1, 2 and 4 are incorrect as they are all functions for which management are responsible.		
Question	Correct answer	Study guide reference
1.18.	3	Study units 1.1.3 and 7.1
Communications must be accurate, objective, clear, concise, constructive, complete, and timely (Standards 2420). Option 3 is correct because clear communications are easily understood and logical, avoiding unnecessary technical language and providing all significant and relevant information. Option 1 is incorrect because concise communication avoids superfluous detail, redundancy and wordiness. Option 2 is incorrect because complete communication lacks nothing that is essential to the target audience and includes all significant and relevant information and observations to support recommendations and conclusions. Option 4 is incorrect because accurate communication avoids errors and distortions.		
Question	Correct answer	Study guide reference
1.19.	3	Study unit 3
Option 3 is correct because receiving ordered goods is the main function of a receiving operation, as is the verification of the quality of the goods received.		

Option 1 is not a risk because a receiving operation should perform this function.

Option 2 is a risk that should be addressed by the human resources department.

Option 4 is a risk for the ordering and payment departments.

Question	Correct answer	Study guide reference
1.20.	4	Study unit 4

Option 4 is correct because the written receipt is the source document for the recording of cash sales in the accounting records and ensures that cash sales are recorded completely.

Option 1 is incorrect because this would be accomplished by counting the cash received and comparing it to the total of the receipts.

Option 2 is incorrect as this would be accomplished by comparing the price charged to an approved price list.

Option 3 is incorrect as this would be ascertained by counting the cash and reconciling the expected total (opening balance plus receipts).