

UNIVERSITY EXAMINATIONS



UNIVERSITEITSEKSAMENS

**UNISA** |  university  
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**AUI3703**

October/November 2014

**THE INTERNAL AUDIT PROCESS: SPECIFIC ENGAGEMENTS AND  
REPORTING**

Duration 2 Hours

100 Marks

**EXAMINERS .**

**FIRST**

**SECOND**

**MS M EDWARDS**

**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	Performance auditing	29
3	Information systems auditing	20
4	Fraud investigations	19
5	Code of ethics, consulting and assurance activities	<u>17</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 **one** alternative only that you consider the most correct alternative. Then write down, as your answer, the number of the subsection and the letter that precedes your chosen 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**    You are an internal auditor performing an audit on the distribution activities of a big mining company. As the internal auditor you are determining management's objectives and then establishing whether the management controls that exist lead to the effective, efficient and economic utilisation of resources. You are therefore busy performing a/an ...
- A      compliance audit
- B      financial audit
- C      performance audit
- D      environmental audit
- 1.2**    Which one of the following audit procedures is more likely to provide significant information when testing for possible fraud in accounts receivable?
- A      Performing analytical review procedures on accounts receivable by comparing outstanding debtors balances over time
- B      Tracing a sample of inventory requisitions from inventory, through billing to the sales journal
- C      Confirming debtor balances by performing a positive debtors circulation.
- D      Vouching entries in the sales journal back to the original orders and delivery notes.

**[TURN OVER]**

- 1.3** Recommendations in audit reports may or may not actually be implemented. Which one of the following alternatives best describes the role of the internal auditor when he or she follows up on the implementation of audit recommendations?
- A The internal auditor should follow up to ensure that appropriate action has been taken in the areas for which recommendations have been made.
  - B The internal auditor has no role to play in this regard and follow up is solely the responsibility of management.
  - C The internal auditor is responsible for the implementation of recommendations
  - D To ensure that external auditors maintain their independence, the internal auditor should ask external audit to follow up on the implementation of their recommendations
- 1.4** The purpose of the Attribute Standards (the 1000 series) is to ... .
- A describe the nature of internal audit activities
  - B describe the characteristics needed for the effective administration of the internal audit activity
  - C describe the criteria against which the performance of the internal audit activities can be measured
  - D describe the actual execution of internal audit activities
- 1.5** Information systems (IS) auditing professionalism is generally indicated by . .
- A employing professional IS auditors
  - B outsourcing the IS audit function
  - C employing professional internal auditors
  - D compliance with internationally recognised standards

- 1.6** The responsibility to identify, assess and manage risk lies primarily with .
- A the internal audit activity
  - B the external auditors
  - C the management of the organisation
  - D the audit committee
- 1.7** An internal auditor is assigned to investigate the economy of operations in a certain section. She is likely to focus her audit procedures on determining the relationship between
- A actual inputs and planned inputs
  - B planned inputs and planned outputs
  - C actual inputs and actual outputs
  - D actual outputs and planned outputs
- 1.8** Specific forms of fraud are identified both in literature and in practice. Which one of the following alternatives is an example of misappropriation?
- A Creating false purchase invoices or destroying supplier credit notes
  - B Creating fictitious employees on the organisation's database.
  - C False claims against suppliers for shortfalls on deliveries and poor quality products.
  - D The irregular transfer of goods or money to a fictitious third party
- 1.9** Generalised Audit Software is designed to allow internal auditors to ... .
- A monitor the execution of application controls
  - B process test data against master files that contain real and fictitious entities
  - C select sample data from files and check computations

**[TURN OVER]**

D Insert special audit routines into regular application programs

**1.10** As part of a performance audit, you as the internal auditor are required to evaluate the company's mission statement. Which one of the following best describe the main purpose of evaluating the mission statement?

- A Find out whether the mission statement is verbally defined.
- B Gain an understanding of the business purpose and ensure that the mission statement does not translate into the reason for the existence of the company
- C Evaluate the performance objectives to ensure that there is no direct link between the performance objectives and the mission statement
- D Discuss with management whether they are keeping the mission statement in line with the changing needs of their customers

## **QUESTION 2**

**29 marks**

Owing to the recent increase in the petrol price, the demand for public transport, especially the use of the Gautrain has increased dramatically. The number of daily commuters using the Gautrain has increased by more than 60% and it is expected to increase even more over the next few months.

You are a senior internal auditor employed by Gauport. Gauport's responsibility is to ensure that the Gautrain operates effectively and efficiently. Gauport also needs to ensure that the Gautrain's operations can handle the increase in commuters on a daily basis.

As the internal auditor of Gauport, you are responsible for auditing the procurement department. The main responsibility of the procurement department is to procure additional train carriages to ensure that all the trains are operating at maximum capacity.

The chief audit executive (CAE) has requested you to focus on the economical procurement of the additional carriages, and to ensure that the operations of the procurement department are effective and efficient.

During the course of the internal audit you discover the following.

- 1 There is no purchasing policy in the department
2. A significant number of tasks are being duplicated in the procurement department
- 3 The department currently has four vacancies that still need to be filled

**[TURN OVER]**

4. No measures are in place for measuring departmental performance.
5. No quotes for train carriages have been obtained, and no supplier list is available.

After various discussions with procurement department personnel, it has come to your attention that there is a delay in delivering the new carriages. During a discussion with Mr Craig, the manager responsible for inspecting the carriages, he explains that once the carriages have been received they will all need to be inspected before they can be delivered to the various stations. He further mentions that a staff shortage has hampered efforts to inspect the new carriages properly. Mr Craig explains that all new carriages should be inspected within 24 hours and, because the carriages have not been inspected, there is a backlog and delivery of the carriages has been delayed. This delay could lead to capacity shortages and could leave some commuters waiting longer for trains.

## REQUIRED

## Marks

- |     |  |     |
|-----|--|-----|
| 2.1 | Formulate <b>six (6)</b> questions to put to the management of the procurement department in order to gain background information on the <i>efficiency</i> of the procurement department   | (6) |
| 2.2 | Develop a complete audit finding based on the information obtained from Mr. Craig in which you specifically mention and illustrate in a practical way all the different elements of an audit finding.                            | (5) |
| 2.3 | Describe the difference between the <i>economy</i> and the <i>efficiency</i> of a process, and indicate for each of the observations made in 1 to 5 above, whether it relates to a lack of economy, efficiency or effectiveness. | (9) |
| 2.4 | Describe <b>six (6)</b> audit procedures that may be used to provide assurance on the <i>economical</i> procurement of the additional train carriages  | (9) |

## QUESTION 3

20 marks

The operations department of Gaucorp is responsible for the information systems (IS) requirements of Gaucorp and the department is responsible for all the IS requirements of the Gautrain operations. During initial discussions with the operations manager, he indicates that the operations department is busy upgrading the online booking systems

The IS audit manager requests you to assist him during the performance of an internal audit on the activities of the operations department

[TURN OVER]

The IS audit manager believes that for an IS auditor to add value to an organisation's operations, the auditor needs to understand the business processes followed within the operations department. You mention to the IS audit manager that, owing to the large volumes of data, you will use CAATS to carry out various audit procedures

To be able to evaluate current and improved internal controls and make recommendations on possible weaknesses and suggest improvements to the internal control system, you as the IS auditor require a thorough knowledge and extensive insight into the control activities and the related internal control measures of the upgraded system.

During the planning phase of the audit you realise that the team responsible for upgrading the new system did not focus on the controls of the system

You briefly list the following controls that could be implemented when upgrading the current system:

- 1 Management should review exception reports on a regular basis
2. Certain controls should be embedded in the application program code and applied by the computer.
- 3 Back-up copies of all masterfiles should be stored off site.
4. All data in the accounting and supporting files should be kept up to date.
5. All parties involved in the testing of the upgraded system should give final approval to the system before it is implemented.

**REQUIRED**

**Marks**

- |            |   |            |
|------------|---|------------|
| <b>3.1</b> | List and briefly describe <b>five (5)</b> steps that should be followed when performing an IS audit.  | <b>(5)</b> |
| <b>3.2</b> | For each of the controls listed in 1 to 5 above, indicate whether they are general or application controls                                  | <b>(5)</b> |
| <b>3.3</b> | Discuss the conditions that you as the IS auditor will take into account when deciding whether or not to use CAATS in the audit engagement. | <b>(5)</b> |
| <b>3.4</b> | Briefly explain to the IS audit manager the benefits of using CAATS during the audit engagement   | <b>(5)</b> |

**[TURN OVER]**

**QUESTION 4**

**19 marks**

Joan James joined Gauport nearly ten years ago. Joan is currently the administration manager of Gauport.

Joan has proved herself over the years and as a result of her hard work and commitment to the company she has been given additional duties. Joan is currently overseeing the work of nearly 300 employees situated at different branches.

After Joan's only child became terminally ill, money became a big issue in Joan's life. Around the same time one of the casual employees situated at the Durban branch resigned. Under normal circumstances Joan would have filled out paperwork showing that this employee had left the company and then sent it to the human resources (HR) department. Only then would she have started looking for a replacement. However, this time Joan did not inform the HR department, but kept on submitting time sheets on his behalf. According to the company's system, pay cheques for casual workers are made out to cash, mailed to Joan and then distributed to the casual workers.

Joan kept on doing this for approximately six months until she was reported through the company's anonymous fraud line. An internal auditor was immediately sent out to investigate the matter and Joan who immediately confessed to everything, was asked to resign.

A criminal case was filed against her. Subsequently, the details of the crime committed and the actions taken against Joan were reported in Gauport's monthly newsletter.

**REQUIRED**

**Marks**

- |            |   |            |
|------------|---|------------|
| <b>4.1</b> | Briefly discuss the factors that motivate people to commit fraud and also indicate which of these factors apparently motivated Joan to commit fraud   | <b>(6)</b> |
| <b>4.2</b> | There is a big difference between the objectives of a fraud investigation and the objectives of other internal auditing projects. Differentiate between the internal auditor's tasks in a normal auditing project and the internal auditor's tasks during a fraud investigation | <b>(8)</b> |
| <b>4.3</b> | Make five (5) practical recommendations for improving the internal controls related to the payment of wages to casual workers in order to prevent similar cases of fraud from occurring in future.  | <b>(5)</b> |

**[TURN OVER]**



## QUESTION 5

17 marks

You have recently been promoted to internal audit manager. You are busy preparing for an in-office training session with newly appointed internal auditors. At an introductory session you will discuss the qualities and abilities that an internal auditor should possess

The first topic will be the "Code of ethics". You will explain the following to the internal auditors:

*A code of ethics is necessary and appropriate for the profession of internal auditors, founded as it is, on the trust placed, in its objective assurance about governance, risk management and control.*

*The IIA's code of ethics extends beyond the definition of internal auditing to include two essential components:*

- 1 Principles that is relevant to the profession and practice of internal auditing.*
- 2 Rules of conduct that describe behaviour norms expected of internal auditors. These rules are an aid to interpreting the principles into practical applications and are intended to guide the ethical conduct of internal auditors*

The second topic will relate to consulting and assurance engagements. You believe that the internal audit function can increase the value it adds to the organisation by expanding the number of consulting services.

### REQUIRED

Marks

- |     |  |     |
|-----|--|-----|
| 5.1 | Describe the principles on which the code of ethics is based   | (8) |
| 5.2 | Differentiate between assurance and consulting services <b>and</b> provide an example of each.   | (5) |
| 5.3 | For your introductory session with the internal auditors, list at least <b>eight (8)</b> qualities and abilities an internal auditor should possess. | (4) |