


**AUI3703
AUI305E**

May/June 2014

THE INTERNAL AUDIT PROCESS: SPECIFIC ENGAGEMENTS AND REPORTING

Duration 2 Hours

100 Marks

EXAMINERS

FIRST

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SECOND

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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 and reporting	51
3	Fraud investigations	<u>34</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 Which one of the following activities, performed by an internal audit activity would be most likely to form part of a performance audit?

- A A comprehensive risk assessment was undertaken and a risk profile was developed for the organisation as well as for individual components
- B The activity assisted the organisation in its efforts to obtain an unqualified Auditor's report for the 2013 financial year
- C Numerous presentations were made to management and employees of the organisation on corporate governance and fraud awareness
- D The activity facilitated the organisation's preparation of adequate performance measurement criteria

1.2 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

1.3 Which one of the audit procedures performed during the conduct of a performance audit was aimed at the evaluation of the economy and efficiency with which resources are being utilised within the organisation?

- A Verify the existence and safeguarding of fixed assets
- B Interview the head of the personnel department to determine whether proper operational standards exist for the organisation

- C Meet with the external auditors and financial management on the valuation of fixed assets
- D Check the accuracy of production figures on quarterly reports, for submission to the board of directors

1.4 Indicate the alternative which correctly completes the following sentence

The Standards for the Professional Practice of Internal Auditing explicitly requires internal auditors, when they suspect irregularities, to –

- A appoint an independent investigation team to investigate the probable fraud
- B suspend the suspected employees so that a complete investigation can be carried out
- C inform the appropriate managers within the organisation thereof
- D interrogate the suspected employees

1.5 An employee in the payroll department is contemplating fraud involving the addition of the name of a fictitious employee and the entry of fictitious hours worked. The pay cheque would then be sent to the fictitious employee's home address as it appears on the payroll. The most effective control measure to prevent this type of fraud is to require that –

- A the particulars of all new employees and the number of hours worked be entered on the payroll by the human resources department
- B a report of all new employees added to the payroll be approved by someone outside the payroll department. In addition, a report showing all employees and the number of hours worked, should be sent to the supervisor's department for review
- C all changes to employee records be approved by supervisors outside of both human resources and the payroll department
- D the payroll department physically deliver the pay cheques to employees, rather than mailing them

1.6 Which one of the following statements is true?

- A Efficiency is the relationship between actual outputs and planned outputs
- B The scope of a performance audit involves the audit of economy, efficiency and effectiveness of operations

[TURN OVER]

- C By reporting findings to the board of directors and the audit committee, the internal auditors can ensure that all their recommendations are implemented
 - D Internal auditors should investigate all frauds reported to the audit committee
- 1.7 An operational audit is performed to determine the *effectiveness* of a new purchasing system implemented for a group of chain stores to improve the speed with which products ordered are supplied to stores in the rural areas. Which one of the following audit procedures is most likely to be found in the audit programme for this audit?
- A Extract a sample of receiving documents from different branches and trace these back to the original purchase orders to determine the time elapsed from when the order was placed until the items were received at the branches
 - B Perform an inventory count at selected branches in the rural areas and determine whether any adjustments to the continuous inventory records are required
 - C Interview the branch managers in the rural areas and determine their satisfaction with the implementation of the centralised purchasing system
 - D Perform an analysis of orders according to the different product ranges at the branches in the rural areas, and compare the results with orders for the same products in the suburban branches
- 1.8 Which one of the following actions describes one of the responsibilities of the internal auditor for the deterrence of fraud in an organisation?
- A Prosecuting perpetrators of fraud
 - B Evaluating the adequacy of controls to prevent fraud
 - C Implementing systems to discourage fraud
 - D Reporting suspected fraud to law enforcement personnel
- 1.9 Which one of the following alternatives represents a warning sign (red flag) that may point to embezzlement of cash?
- A Lost deposit slips
 - B Unusual inventory shortages
 - C Unusual year-end transactions
 - D Excessive overtime

1 10 Fraud was recently discovered in the sales department. After finalisation of the fraud investigation, the management of the sales department requested you as the internal auditor to assist them with improving their current policies and procedures. To best fulfil your responsibility as an internal auditor, you should

- A document and distribute required policy and procedures and ensuring implementation thereof
- B recommend specific improvements to the policy and procedures
- C request the supervisor to draft and implement the policies and procedures
- D perform a compliance audit on the department within the next 6 months

QUESTION 2

51 marks

ReadAlot is an online bookstore. Orders from all over the country is placed online and then books ordered delivered via door-to-door courier services.

You are responsible for performing an internal audit on the different departments within ReadAlot. The three departments that will be included in the performance audit will be

- Administrative department – responsible for processing all orders received via the internet
- Packaging department – responsible for packing all the books into the boxes and handing the books over to the distribution department
- Distribution department – responsible for delivering all packages within the required due dates

Due to an increase in online shopping recently, ReadAlot's sales increased with 35%, and with the festive season approaching a further increase in sales are expected. The management of ReadAlot requested the internal audit activity to perform a performance audit of the efficiency and effectiveness of the operations of ReadAlot, to ensure that ReadAlot will be able to meet the increase in sales.

Part A

You have been assigned to join a team of three auditors to perform the performance audit on the administrative department. You will be responsible for finalising and maintaining the audit budget for the project and determining the efficiency and effectiveness of the administrative department.

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As part of the planning, you have been provided with numerous files containing relevant information such as the mission, performance objectives, key performance indicators and details of order status reports. While reviewing the business plan and mission of ReadAlot, you noted, in one of the files containing the minutes of a management meeting, the following key issues:

- 1 Orders are not always completed on time
- 2 40% of the orders are not completed within the budget, with an overspending on overtime
- 3 No procedure or guidelines in place for the administrative department
- 4 Targets of the department are not met, the managers noted that the targets set for the department is not realistic. Furthermore, no feedback is given to managers or employees regarding targets being met or not
- 5 The approach to setting the targets are not clear
- 6 Targets are not measured on a regular basis and there is no indication as to what measurements are used to determine whether the targets are met or not
- 7 Targets are not in line with the mission statement of ReadAlot
- 8 No detailed plans regarding objectives and targets were communicated to staff

In planning the audit, the internal auditors decided to arrange interviews with Smart Power's management and managed to obtain the following documents from previous audit files and company records:

- 1 The organogram setting out the personnel and reporting structure
- 2 System flow charts for the order process
- 3 Layout flow charts for the order process
- 4 A list of personnel working in the administrative department, their individual positions and job descriptions for each post

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REQUIRED	Marks
2.1 Discuss the mission of ReadAlot in the context of organisational performance Elaborate on the relationship between mission and performance objectives	(5)
2.2 List the steps that you will follow to evaluate the mission statement of ReadAlot	(6)
2.3 From the information in the scenario, identify and describe five (5) weaknesses that have a direct impact on the effectiveness of the administrative department	(5)
2.4 Identify five (5) audit techniques that may be used in the performance of this audit and describe how each of them will be used to audit the effectiveness of the administrative department	(10)
2.5 Formulate ten (10) questions to put to the management of ReadAlot to gain background information on the efficiency of the administrative department	(10)

Part B

Once an order has been processed by the administrative department it is forwarded to the packaging department. It is the responsibility of the packaging department to pack all orders and then forward the packages to the distributions department.

Initial discussions with the management of the packaging department have indicated that 500 orders are packed per day. It is of the utmost importance to ensure that all orders are ready for delivery as soon as possible as all orders need to be delivered within 24 hours.

The following information was obtained from the manager of the packaging department:

A staff shortage has hampered the efforts to pack all orders and to get them ready for delivery within 24 hours as specified in the terms of sale. It was further mentioned that for each 24 hours that the orders are delivered late the customer would receive an additional 10% discount on their purchase. Due to the backlog experienced in the packaging department most of the orders are delivered late.

The following additional information was obtained regarding the packaging department:

- There are currently no policies and procedures in place for the packaging department.

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- None of the employees are aware of the targets or objectives of the department
- All procedures within the packaging department is manual, as the manager of the department said that he does not want to get involved in new technology or new procedures
- The current staff of the packaging department is overworked due to the shortage of staff in the department
- One of the staff members admitted that she feels some of the tasks are being duplicated within the packaging department

REQUIRED

Marks

- 2.6** List at least **ten (10)** qualities and abilities an operational auditor should possess **(5)**
- 2.7** Develop a complete audit finding based on the information obtained from the manager of the packaging department, in which you specifically mention and illustrate in practical ways all the different elements of an audit finding **(5)**
- 2.8** From the information provided, identify and describe **five (5)** weaknesses directly impacting on the **efficiency** of ReadAlot **(5)**

QUESTION 3

34 marks

The distribution department of ReadAlot is responsible for collecting all the packed orders at the warehouse and then deliver them within 24 hours to the customers. Due to the increase in sales the personnel in the distribution department are working extra hours and spending a lot of additional hours on the road. As a result that leaves little time for manager-employee interaction and oversight.

Drivers are appointed on a contract basis and are paid a fixed rate per hour. The distribution department does not advertise for drivers as they prefer to use friends and family of current employees due to the fact that it is a lot quicker than to appoint someone formally. The culture of the company is very trusting with very few rules. A newly appointed employee only has to sign an agreement that they do have a valid driver's licence. A staff member was fired recently, but although the reason was rumoured to be due to fraudulent behaviour, nobody really knew why.

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Due to the expected increase in sales it became clear that additional delivery vans will have to be purchased for the distributions department. The Chief Audit Executive has requested you to investigate the economical procurement and efficient utilisation of the new delivery vehicles that will be purchased. You are in the process of obtaining background information on the procedures followed and the processes employed when purchasing new vehicles.

REQUIRED	Marks
3.1 Identify the weaknesses in the distribution department's operating procedures that would encourage fraudulent behaviour and for each weakness briefly describe why this would be the case	(10)
3.2 Describe eight (8) audit procedures that could be used to provide assurance with regard to the economical purchase of the new equipment	(12)
3.3 Briefly discuss the factors that motivate people to commit fraud	(3)
3.4 Indicate how the tasks of the internal auditor during a fraud investigation would differ from the tasks performed during a performance audit of the distributions department	(9)