

**AUI3703**

May/June 2016

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

Duration 2 Hours

100 Marks

**EXAMINERS**

FIRST

MR BL SHABANGU

SECOND

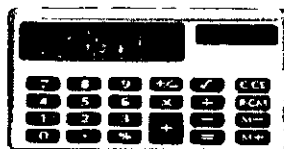
MRS BM VAN WYK

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Use of a non-programmable pocket calculator is permissible

Closed book examination

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THIS PAPER CONSISTS OF **seven (7)** PAGES

QUESTION	MAIN TOPIC	MARKS
1	Multiple-choice questions	15
2	Performance auditing	30
3	Fraud investigations	28
4	Information systems auditing and controls	22
5	Code of ethics, Standards and Reporting	<u>5</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

**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 The purposes of the Standards include all of the following **except** ...
- A establishing the basis for the measurement of the internal audit performance
  - B guiding the ethical conduct of internal auditors
  - C stating basic principles that represent the practice of internal auditing
  - D fostering improve organisation processes
- 1 2 Engagement information is usually considered relevant when it is
- A derived through valid statistical sampling
  - B objective and unbiased
  - C factual, adequate and convincing
  - D consistent with the engagement objectives
- 1 3 An inexperienced internal auditor notified the senior auditor of a significant variance from the engagement client budget. The senior told the new internal auditor not to worry because the senior had heard that there has been an unauthorised stoppage that probably accounted for the difference. Which of the following statements is most appropriate?
- A The new internal auditor should have investigated the matter fully and not bothered the senior
  - B The senior used proper judgement in curtailing what's could have been a wasteful investigation
  - C The senior should have halted the engagement until the variance was fully explained
  - D The senior should have aided the new internal auditor in formulating a plan for accumulating appropriate information
- 1 4 A primary purpose for establishing a code of conduct with a professional organisation is to
- A reduce the likelihood that members of the profession will be sued for substandard work
  - B ensure that all members of the profession perform at approximately the same level of competence
  - C promote ethical culture among professionals who serve others
  - D require members of the profession to exhibit loyalty in all members pertaining to the affairs of their organisation

- 1 5 In the course of their work, internal auditors must be alert to fraud and other forms of white collar crime. The important characteristic that distinguishes fraud from other varieties of white collar crime is that
- A fraud is characterised by deceit, concealment or violation of trust
  - B unlike other white-collar crimes, fraud is always perpetrated against an outside party
  - C white-collar crime is usually perpetrated for the benefit of an organisation, but frauds benefit others
  - D white-collar crime is usually perpetrated by outsiders to the detriment of the organisation but fraud is perpetrated by insiders for the benefit of the organisation
- 1 6 Which of the following is not considered a red flag?
- A Management has delegated the authority to subordinates to make purchases under a certain value
  - B An individual has held the same cash handling job for an extended period without any rotation of duties
  - C An individual handling marketable securities is responsible for making the purchases, recording the purchases, and reporting any discrepancies and gain/losses to senior management
  - D The assignment of responsibility and accountability on the accounts receivable department is not clear
- 1 7 Which of the following should the auditor recommend as the most economical point at which to correct input errors in an online system?
- A Input data are balanced with computer-produced control totals
  - B Entry of data into each field of a record is completed
  - C Output data are balanced with computer produced control totals and delivered to the user
  - D Entry of data into each record is completed
- 1 8 Rejection of unauthorised modification to applications system could be accomplished through the use of
- A programmed checks
  - B batch controls
  - C implementation controls
  - D one-by-one checking
- 1 9 The following audit procedure was documented in the working paper file "To determine whether document flow and the provision of management information throughout the delivery department are optimised" This audit procedure will relate to
- A the economy of the process
  - B the efficiency of the process
  - C the effectiveness of the process
  - D the financial impact of the process
- 1 10 Which of the following statements is true?
- A Effectiveness is the relationship between planned inputs and actual output
  - B Economy is the relationship between planned inputs and actual inputs
  - C Efficiency is the relationship between actual input and actual output
  - D Effectiveness is the relationship between planned inputs and actual inputs

## QUESTION 2

**30 marks**

You are the internal auditor of a manufacturing company, called “We Make It (Pty) Ltd” The company conducts its business with a variety of customers that vary in size, from small size retailers to franchise supermarkets. The company has various departments which include the marketing, ordering, production, sales and finance departments.

Management requested you to perform a performance audit on the ordering, sales production and dispatch processes of We Make It (Pty) Ltd.

Initial discussions with the chief operations officer revealed the following:

- I Orders are received through different sources (email, fax and telephone). Telephone orders are scripted on the diary.
- II Orders are received by reception. The receptionist forwards the orders to one of the sales staff who then forward them to production. The sales department is responsible for approving the orders before they are processed for production.
- III The sales department approves all orders received.
- IV There are four staff members in the sales department. However, responsibilities of the staff members are not formally defined.
- V Invoices are issued by the sales department immediately after the orders have been forwarded to the production section.
- VI The pricing of orders is done by production section.
- VII The company has a huge warehousing facility.
- VIII The company leases some of the machinery and equipment from various suppliers at different prices.
- IX Production supplies are ordered by the receptionist on an *ad hoc* basis.
- X Supplies are ordered from a company that is owned by a university friend of the CEO.
- XI Dispatch staff sit under the tree on the company property for long periods of time. Upon inquiry from the dispatch supervisor, you are told that it is because there are no deliveries to be made.
- XII The customers have returned some of the deliveries due to quality concerns.

A1 – Upon inspection of some of the delivery notes, you see that there are items on the delivery note that the customers did not accept delivery of, as they indicated that they had never ordered them. The customers also indicated that the items that they did order was not delivered.

### REQUIRED

**Marks**

- 2.1** For each of the statements (I to XIII) made above, indicate whether it relates to effectiveness, efficiency or economy and formulate an audit procedure for each of the statements that you can use to complete the audit. **(20)**

Present your answer in a tabular format.

Number of statement	Efficiency, economy or effectiveness	Audit procedure

- 2.2 Based on the observation made in A1, draft an audit finding providing a practical illustration of the different **elements** of an audit finding (10)

### QUESTION 3

28 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.

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.

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 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 (6)

#### QUESTION 4

**22 marks**

Over the years We Make it (Pty) Ltd has automated some of their systems in the sales, production and finance divisions. The three departments are considered to be the nerve center of the company. The company has an Information Technology (IT) department that provides information and communication technology (ICT) support.

The company is considering upgrading its systems, therefore the company will be more exposed to risks regarding new IT systems. The IT Manager has engaged the services of the internal audit activity. The IT manager requires the control status of the current systems.

The CAE has agreed to assist the IT Manager. As the company systems are automated, this calls for the internal audit activity to use computer assisted audit techniques (CAATs).

#### REQUIRED

- 4.1** Step 3 of the IT audit process is the "EVALUATION OF INTERNAL CONTROLS". Name each component of step 3 of the IT audit process, including a short explanation of each component. **(10)**
- 4.2** Differentiate between general controls and application controls. Provide two (2) examples of each. **(7)**
- 4.3** Provide five (5) risks associated with new IT Systems. **(5)**

#### QUESTION 5

**5 marks**

We Make It (Pty) Ltd is a 25 year old company. Over the years, the internal audit activity has enjoyed the support of the chief executive officer (CEO) and the Board of Directors. The past CEO used to sing the praises of the internal audit activity and mentioned constantly how the activity has assisted the company to improve its operations. The company has a very comprehensive Internal Audit Charter and Code of Ethics, identical to the ones proposed by the Institute of Internal Auditors, which have been approved by the board. The internal audit activity enjoys a high status level in the organisation and the chief audit executive (CAE) sits in all the management meetings. The CAE reports functionally to the audit committee and administratively to the CEO.

However, the company has recently hired a new CEO. At a recent audit committee meeting the newly appointed CEO raised the following concerns:

- 1 Whether there was a need for the Code of Ethics, when the company has its own Code of Conduct
- 2 Whether the reporting channel of the internal audit activity is correct
- 3 The CEO suggested that the final internal audit reports must be edited by him

REQUIRED	Marks
5.1 How would you respond to the questions and proposal of the new CEO?	(3)
5.2 5.2 The International Standards for the Professional Practice of Internal Auditing are divided into attributes and performance standards. Briefly describe these two elements.	(2)

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