



AUI3703

May/June 2017

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

Duration 2 Hours

100 Marks

EXAMINERS

FIRST

SECOND

MRS BM VAN WYK

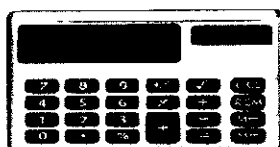
MS M EDWARDS

Use of a non-programmable pocket calculator is permissible

Closed book examination

This examination question paper remains the property of the University of South Africa and may not be removed from the examination venue

[TURN OVER]

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THIS PAPER CONSISTS OF **EIGHT (8)** PAGES

QUESTION	MAIN TOPIC	MARKS
1	Multiple-choice questions	15
2	Performance auditing	26
3	Fraud investigations	23
4	Information systems auditing	25
5	Code of ethics, Assurance and Consulting services	<u>11</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 The five pillars of a security policy are

- A. authentication, non-repudiation, confidentiality, availability and access
- B. integrity, competence, authentication, validity and authorization
- C. confidentiality, application, integrity, application and authentication
- D. authentication, integrity, confidentiality, non-repudiation and authorisation

1.2 Which one of the following sentences best describes some of the risks associated with internet connection

- A. authentication, non-repudiation, confidentiality, availability and access
- B. integrity, competence, authentication, validity, and authorisation
- C. unauthorised access, loss of data integrity and refusal of service
- D. confidentiality, application, integrity and authentication

1 3 The most common motivation for management fraud is the existence of

- A. vices, such as a gambling debt
- B. job dissatisfaction
- C. financial pressures on the organisation
- D. the challenges of committing the perfect crime

1.4 Which one of the following procedures forms part of an investigation into effectiveness?

- A. evaluation of the allocation of responsibilities and authority within an organisation
- B. evaluation of the adequacy of management's method of measuring effectiveness
- C. evaluation of the staffing in relation to the functions that has to be performed
- D. evaluation of the efficiency and application of operating systems and procedures

[TURN OVER]

- 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 The chief financial officer has requested the internal audit activity to perform a performance audit on operational expenditure. All staff members are, however, currently engaged in other audit projects. Which one of the following reasons will play the **smallest** role in deciding whether or not to reassign some of the audit staff?
- A. During the year-end six months ago, the external auditors performed a financial audit on operational expenditure
 - B. Seven months ago, two new managers as well as an administrative person were appointed to assist with operational expenditure
 - C. During the yearly planning of the internal audit activity, a performance audit of operational expenditure was scheduled to be carried out in six months' time
 - D. A legal case has been filed against the company for payments in arrear, and some of the internal auditors are assisting management with the investigation
- 1.7 As part of a performance audit, you are required to evaluate the company's mission statement. Which one of the following steps would you take when 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 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 their mission statement in line with the changing needs of their customers

1.8 Which one of the following statements is **true**?

- A. Efficiency is the relationship between inputs and outputs
- B. The scope of a comprehensive audit involves the audit of economy, efficiency and effectiveness of operations
- 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

1.9 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 is 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 A performance 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 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 continuous inventory records are required
- C. Interview the branch managers in the rural areas and determine their satisfaction with the implementation
- 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

QUESTION 2

26 marks

Current Limited manufactures and imports electrical equipment and then sells it to large chain stores and electrical suppliers in Africa. One of the divisions of Current Limited, Smart Power, develops and manufactures a range of products aimed at reducing electricity consumption. Because of electricity shortages which resulted in power cuts throughout South Africa, the demand for electricity saving devices has increased so much that Smart Power ran out of manufacturing capacity.

[TURN OVER]

Smart Power's management has requested for the purchase of additional equipment in order to increase its manufacturing capacity, but the executive directors of Current Limited do not regard this as necessary. They have requested the internal auditors to perform a performance audit of Smart Power's manufacturing facilities in order to identify areas where the efficiency of the plant could be improved.

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:

- i The organogram setting out the personnel and reporting structure
- ii System flow charts for the different manufacturing processes
- iii Layout flow charts for the different manufacturing processes
- iv A list of personnel working in the manufacturing processes, their individual positions and job descriptions for each post

REQUIRED

Marks

- 2.1 Explain why it is important to have the cooperation of Smart Power's management for this audit (4)
- 2.2 Briefly explain the importance of a good *opening* to an interview and list at least **five (5)** aspects to be kept in mind when opening the interviews with Smart Power's management (6)
- 2.3 For each of the four documents listed above discuss what information can be obtained from the document and how the information may be utilised (10)

Present your answer in table format, using the example below

Document	Information to be obtained from each document	How it may be utilised in the audit
Organogram		

- 2.4 Formulate **six (6)** questions to put to Smart Power's management to gain background information on efficiency of Smart Power's manufacturing processes (6)

[TURN OVER]

QUESTION 3

23 marks

A software development company has been operating for only two years. Because the company is new, programmers are working extra hours and spending a lot of their time developing new products that can be sold to customers. All the programmers are busy, leaving little time for manager-employee interviews and oversight. Programmers are appointed on a contract basis and paid a fixed rate per hour. Performance bonuses, based on the programmers' contribution to new products during the year, are paid annually. The company does not advertise for new programmers, as they have a pool of friends and family of existing staff members to select from. The culture of the company is trusting, with very few rules. All new employees are merely required to sign an agreement not to transfer company software secrets to other organisations. A staff member was fired recently, but although the reason was rumoured to be fraudulent behavior, nobody really knew why.

REQUIRED

Marks

- | | | |
|------------|--|------------|
| 3.1 | Identify the weaknesses in the software company's operating procedures that would encourage fraudulent behaviour <u>and</u> for each weakness briefly describe why the weakness encourages fraudulent behaviour | (8) |
| 3.2 | Describe the actions that the management of the company should take in response to an alleged incident of fraud | (4) |
| 3.3 | Describe six (6) requirements for the success of a fraud hotline within the company | (6) |
| 3.4 | Mention five (5) proactive hiring and promotion procedures the company can introduce that should limit the chance of hiring individuals with low levels of honesty | (5) |

QUESTION 4

25 marks

The operations department of the 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 in the process of upgrading the online booking systems.

The IS audit manager requested 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 computer assisted audit techniques (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

- | | | |
|------------|--|-------------|
| 4.1 | List and describe five (5) steps that should be followed when performing an IS audit | (10) |
| 4.2 | For each of the controls listed in 1 to 5 above, indicate whether they are general or application controls | (5) |
| 4.3 | 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 | (5) |
| 4.4 | Briefly explain to the IS audit manager the benefits of using CAATs during the audit engagement | (5) |

[TURN OVER]

QUESTION 5

11 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 are relevant to the profession and practice of internal auditing*
- 2 Rules of conduct that describe behavior norms expected of internal auditors. These rules are in 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 extend of consulting services.

REQUIRED

- | | | |
|------------|--|------------|
| 5.1 | Describe the principles on which the code of ethics of the IIA is based | (6) |
| 5.2 | Describe the difference between assurance and consulting (advisory) services and provide an example of each | (5) |