



AUI3704

May/June 2016

MANAGING THE INTERNAL AUDIT ACTIVITY

Duration 2 Hours

100 Marks

EXAMINERS

FIRST

SECOND

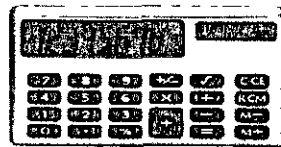
MRS BM VAN WYK

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

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THIS PAPER CONSISTS OF **NINE (9)** PAGES

QUESTION	MAIN TOPIC	MARKS
1	Multiple-choice questions	15
2	Code of ethics	15
3	King III	30
4	Risk management	12
5	IIA Standards	<u>28</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 to be 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 for 1½ marks

1.1 Which one of the following statements is true with respect to due professional care?

- A An engagement communication should never be viewed as providing an infallible truth about a subject
- B An internal auditor should perform detailed tests of all transactions before communicating results
- C An item should not be mentioned in an engagement communication unless the internal auditor is absolutely certain of the item
- D An internal auditor has no responsibility to recommend improvements

1 2 Which of the following values is not one of the values needed by a company to be a “responsible corporate citizen” according to the King III report?

- A Responsibility
- B Fairness
- C Accountability
- D Openness

- 1.3** The King III report refers to integrated reporting. The concept of integrated reporting refers to the company reporting upon
- A economy, efficiency and effectiveness
 - B governance, risk management and control processes
 - C financial performance as well as the sustainability of the company
 - D financial performance as well as compliance with laws and regulations
- 1.4** You have been asked to develop an internal audit department for your organisation. Which one of the following approaches would you most likely follow as far as it concerns the appointment of audit personnel?
- A Appoint mostly accountants, since most audit work is accounting related
 - B Appoint internal auditors who collectively have the knowledge and skills needed to complete internal audit assignments
 - C Appoint internal auditors each of whom possess all the skills required to handle all audit assignments
 - D Appoint inexperienced personnel and train them the way the organisation wants them trained
- 1.5** Which one of the following alternatives expresses the main reason for co-ordinating the efforts of the internal and external auditor?
- A To increase the reliability of the published financial statements
 - B To minimise the annual external audit fees
 - C To increase the effectiveness of internal financial controls
 - D To obtain maximum effectiveness and efficiency of the total audit effort

- 1.6 Which one of the following audit committee activities would be of the greatest benefit to the internal audit activity?
- A Review and endorsement of all internal auditing reports prior to release
 - B Review and approval of audit programmes
 - C Support for appropriate follow-up of recommendations made by the internal audit activity
 - D Assurance that the external auditor will rely on the work of the internal audit activity whenever possible
- 1.7 Internal audit demonstrates its professionalism by
- A adhering to the Standards for the Professional Practice of Internal Auditing
 - B reviewing operational systems to determine their effectiveness and efficiency
 - C meeting ISO 9000 quality standards
 - D meeting deadlines on audits performed
- 1.8 When assessing the risk associated with an activity, an internal auditor should
- A determine how the risk should best be managed
 - B update the risk management process based on risk exposures
 - C design controls to mitigate the *identified risks*
 - D provide assurance on the management of the risk
- 1.9 Which one of the following is **not** a role of the internal audit activity according to best practice governance activities?
- A Support the board in enterprise-wide risk assessment
 - B Ensure the timely implementation of audit recommendations

- C Monitor compliance with the corporate code of conduct
- D Discuss areas of significant risks

1.10 Engagement working papers are reviewed to ensure that

- A They are properly cross-referenced to the engagement communications
- B No issues are open at the conclusion of the field work
- C They meet or exceed the work standards of the organisation's external auditors
- D They are properly referenced for easy follow-up within the next year

Question 2

15 marks

You are currently an internal auditor working for a consulting firm specialising in internal audit. Part of your duties requires you to provide consulting advice to internal audit departments regarding their activities and their subsequent compliance to the code of ethics based on their activities. You have been assigned to XYZ Limited to advise their internal audit department.

The Chief Audit Executive (CAE) has provided you with a list of activities of his staff which he would like ethical clearance on. He requires you to indicate to him if the activity is in violation of the code of ethics and, if so, the principle and rule that has been violated and the correct action that should have been taken.

- a) During one of the reviews conducted by one of the senior internal auditors, the auditor believed that toxic waste was being dumped by the organisation in violation of the law. Out of loyalty to the organisation, no information regarding the dumping was collected.
- b) The CAE disagrees with the engagement client about the observations and recommendations in a sensitive area. The CAE discusses the detail of the observations and the proposed recommendations with a fellow CAE from another organisation to confirm that he is doing the correct thing.
- c) During the course of an audit, one of our internal auditors discovers that a clerk is embezzling funds from the organisation. Although this is the first embezzlement ever encountered and the organisation has a security department, the internal auditor decides to interrogate the suspect.
- d) One of the senior internal auditors has been approached by a smaller company in the similar business area to serve on the board of directors. The smaller company competes

in many of the same markets as the company the internal auditor currently works for. The internal auditor accepted the position as he believes it will not directly affect the company as he does not work in sales.

- e) In a review of travel and entertainment expenses, a certified internal auditor questioned the business purposes of a director's reimbursed travel expenses. The director promised to compensate for the questioned amounts by not claiming legitimate expenses in the future. The internal auditor accepted this agreement as the person in question is a director in a high position at the company.

Required

15 Marks

Indicate, for each scenario, if it is in violation of the code of ethics and, if so, the principle and rule that has been violated and the correct action that should have been taken. Put your answer according to the following table.

Scenario	Violation	Principle or rule	Correct action
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Question 3

30 Marks

You are a senior trainee in a firm of registered accountants. One of your partners, Morné Olivier, has been approached by the chairman of Bulle (Pty) Ltd, a large textile manufacturer, to accept an appointment as a non-executive director of the company. There is no connection between Morné Olivier or your firm and Bulle (Pty) Ltd. Morné Olivier had been recommended to the chairman of Bulle (Pty) Ltd by a mutual friend.

Before considering the appointment, Morné Olivier informed the chairman that he would like to get an idea of the company's adherence to sound corporate governance and particularly to King III. The chairman replied that he personally didn't know too much about "that stuff" but that Morné Olivier could come to the offices and look through the minutes of directors' meetings if it would help. Morné Olivier has sent you to "have a look" and report back. The company secretary provided you, inter alia, with the following minutes:

Minutes of the second and final meeting of the Board of Directors for the financial year 2016 held at 9am on 15 May 2016 at the company's head office.

1. Attendance

****quorum***

All directors either attended the meeting or tendered their apologies. As five directors were present, the quorum of four was met.

****chairperson*** Hennie Meyer, the chairperson of the board, was present.

****other directors present***

- Wynand Nel chief financial officer and deputy chairperson
- Frik Welsh production director

- Akon Ndungane non executive director
- Lucas Watson human resources director

**apologies*

- Barry Botha non-executive director and Bulle (Pty) Ltd's major supplier
- Pieter Spies non executive director and 20% shareholder in Bulle (Pty) Ltd
- Danny Rewsow marketing director

**also in attendance*

- Hennie Adams internal audit manager
- Victor Hatfield company secretary

2 *Company Performance*

Mr Hennie Meyer, in his capacity as chief executive officer, delivered his report on the company's performance for the year to date

Copies of this report and all Board Committee reports have been lodged with the company secretary

3 *Board Committee Reports*

Reports from all Board Committees were tabled at the meeting

Audit committee - Mr Wynand Nel, in his capacity as chairperson, outlined the successes of the audit committee over the year which he attributed largely to the appointment to the committee at the start of the year of Mr Barry Botha, whom he said had brought a wealth of experience to the committee. He also explained that much of the audit committee's time had been taken up reviewing the reports on the various compliance audits which he had instructed internal audit to carry out, based on a random selection of systems and cycles within the company. Hennie Adams, the internal audit manager, and third member of the three person audit committee, then outlined the discussions held with the external auditors pertaining to the upcoming audit of the annual financial statements for the 30 June 2014 year-end

4 *Resolutions – maintenance contract*

It was unanimously agreed by all of those directors present that the R10 million *machinery maintenance* contract be awarded to Akon Ndungane's company Wingz (Pty) Ltd for the next three years, as this company had provided excellent service in the past

The Chairperson thanked everyone for their attendance at the meeting and closed the meeting at 10 35am

Required

30 Marks

You are required to critically evaluate Bulle (Pty) Ltd's corporate governance and compliance with the requirements of King III based on the information presented above. You may

assume that the minutes are an accurate reflection of all the matters discussed at the meeting

(Adapted from Graded Questions on Auditing)

Question 4

12 Marks

You are currently an internal auditor at XYZ Company. You have been assigned to the internal audit of the revenue and receipts cycle. As part of the preliminary planning you have been asked to identify risks based on the policy of the company. The following are some of the controls in place with regards to the revenue and receipts cycle:

- a. All orders are recorded on a sequentially numbered sales order form
- b. No orders must be accepted by the order clerk if the customer is not an approved customer
- c. Before processing any orders, checks are made by the credit department to establish that the customer has not supplied any fictitious details and the customer's credit status is satisfactory
- d. Supervisory checks are conducted to ensure that all goods picked are supported by a signed picking slip
- e. The warehouse clerk compares the goods picked to the picking slip
- f. The warehouse clerk also prepares the delivery note from the picking slip and cross references it

Required

Marks

- | | | |
|------------|---|------------|
| 4.1 | Briefly describe the steps that should be carried out in the risk management process? | (6) |
| 4.2 | For each of the controls listed above (a-f), identify the risk that the control is mitigating | (6) |

Question 5

28 Marks

You are a newly appointed chief audit executive (CAE) and during a recent meeting with the chairperson of the audit committee, he requested you to clarify all uncertainties around the IIA standards that were raised at the last audit committee meeting.

Required

Marks

- | | | |
|------------|--|------------|
| 5.1 | Differentiate between internal quality assessment and external quality assessment | (5) |
| 5.2 | Describe the benefit of external quality assessments? | (7) |

- | | | |
|------------|---|------------|
| 5.3 | Explain how and when you as the CAE can use the term “conforms with the International Standards for the Professional Practice of Internal Auditing” (IIA Standards) | (3) |
| 5.4 | Define an internal audit charter and the purpose thereof | (5) |
| 5.5 | Should the CAE outsource certain audit to an external service provider? Provide full reasons in terms of the Standards | (5) |
| 5.6 | Discuss the reasons according to the IIA Standards why audit engagements need to be properly supervised? | (3) |