



AUI3704

October/November 2017

Managing the Internal Audit Activity

Duration 2 Hours

100 Marks

EXAMINERS

FIRST

SECOND

MRS BM VAN WYK

MRS I MORGAN

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	Human Resource Management	30
3	IIA Standards	25
4	King III	12
5	Code of ethics	<u>18</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 An internal auditor often encounters unusual problems when performing an engagement at a foreign subsidiary. Which of the following statements is **false** with respect to the performance of international audit engagements?

- A The IIA standards do not apply outside of the United States of America (USA)
- B The internal auditor should determine whether managers are in compliance with the local laws.
- C There may be justification for having different organisational policies at foreign branches
- D It is preferable to have multilingual internal auditors conduct engagements at branches in foreign countries

1.2 Internal auditing has planned an engagement to evaluate the effectiveness of the quality assurance department as it affects the receipt of goods, the transfer of the goods into production, and the costs related to scrap defective items. The engagement client argues that such an engagement is not within the scope of the internal audit activity and should reside under the review of the quality assurance department only. What is the most appropriate response to this statement?

- A Refer to the internal audit activity's charter and the approved engagement plan that includes the area designated for evaluation in the current time period
- B Because quality assurance is a new function, seek the approval of management as a mediator to set the scope of the engagement
- C Indicate that the engagement will evaluate the function only in accordance with the standards set by the quality assurance function before beginning the engagement
- D Terminate the engagement because it will not be productive without the client's cooperation

- 1 3 Which one of the following conditions by themselves, could affect the independence of the internal audit activity?
- I The chief executive officer (CEO) accused the new auditor of not operating “in the best interests” of the organisation
 - II The majority of audit committee members come from within the organisation
 - III The internal audit activity’s charter has not been approved by the board.
- A I only
B II only
C II and III only
D I, II and III
- 1 4 To avoid being the apparent cause of conflict between an organisation’s senior management and the Board, the chief audit executive (CAE) should .
- A communicate all engagement results to both senior management and the Board.
B strengthen the independence of the internal audit activity through the organisational structure
C discuss all reports to senior management with the Board first
D request Board approval of policies that include the internal audit activity’s relationship with the Board
- 1 5 When evaluating the independence of an internal audit activity, a quality assurance review team performing an external assessment, should consider several factors Which of the following factors has the **least** amount of influence when judging an internal audit activity’s independence?
- A Criteria used in allocating internal auditors to assignments.
B The extent of internal auditor training in communication skills
C Relationship between engagement records and engagement communications
D Impartial and unbiased judgments
- 1 6 Which of the following statements is an appropriate reason for the internal audit activity **not** to participate in the systems development process?
- A Recommendations prior to implementation will affect independence, and the internal auditors will not be able to perform an objective evaluation after the system is implemented
B Participation will delay implementation of the project
C Participation will cause the internal auditors to be labelled as partial owners of the application and they will then have to share the blame for any problems that remain in the system
D None of the answers are correct

- 1 7 A chief audit executive (CAE) for a very small internal audit department has just received a request from management to perform an audit of an extremely complex area in which the CAE and the department have no expertise. The nature of the audit engagement is within the scope of internal audit activities. Management has expressed a desire to have the engagement conducted in the very near future because of the high level of risk involved. Which of the following responses by the CAE would be in violation of the IIA Standards?
- A Discuss with management the possibility of outsourcing the audit of this complex area
 - B Add an outside consultant to the audit staff to assist in the performance of the audit engagement
 - C Accept the audit engagement and begin immediately, since it is a high-risk area
 - D Discuss the timeline of the audit engagement with management to determine if sufficient time exists in which to develop appropriate expertise
- 1 8 An individual became head of the internal audit activity of an organisation one week ago. An engagement client has come to the person complaining vigorously that one of the internal auditors is taking up an excessive amount of client time on an engagement that seems to be lacking a clear purpose. In handling this conflict with a client, the person should consider
- A discounting what is said, but documenting the complaint
 - B whether existing procedures within the internal audit activity provide for proper planning and quality assurance
 - C presenting an immediate defence of the internal auditor based upon currently known facts
 - D promising the client that the internal auditor will finalise the work within one week
- 1 9 Which of the following is part of an internal audit activity's quality assurance program, rather than being included as part of other responsibilities of the chief audit executive (CAE)?
- A The CAE provides information about and access to internal audit working papers to the external auditors to enable them to understand and determine the degree to which they may rely on the internal auditors' work
 - B Management approves a formal charter establishing the purpose, authority and responsibility of the internal audit activity
 - C Each individual internal auditor's performance is appraised at least annually
 - D Supervision of an internal auditor's work is performed throughout each audit engagement

1 10 During discussions with senior management, the chief audit executive (CAE) identified several strategic business issues to consider in preparing the annual audit work schedule. Which of the following does **not** represent a strategic issue for this purpose?

- A A monthly budget process will be implemented
- B An international marketing campaign will be started to develop product recognition and also to leverage the new organisation-based advertising department
- C Joint venture candidates will be sought to provide manufacturing and sourcing capabilities in European and Asian markets
- D A human resources database will be established to ensure consistent administration of policies and to improve data retention

QUESTION 2

30 marks

Dyson (Pty) Ltd is a large manufacturing company that adheres to high standards of corporate governance. The company has a strong internal audit department as well as an audit committee. The chief audit executive (CAE), Floyd Mayweather, having provided human resources with the characteristics he is looking for in the appointee for the position of an internal audit manager, is currently reviewing the comments pertaining to each of the applicants who had been interviewed. The comments are as follows:

Carmen Naidir	Newly qualified chartered accountant (CA), two years post-trainee experience as a line accountant in a retail organisation. Very softly spoken and nervous.
Zee Zidane	B Com (Accounting), six years of experience with internal audit at SARS. Very thorough, an independent thinker, very aggressive in her approach to people.
Joe Royle	C.I.S. (Chartered Institute of Secretaries), five years' experience as the company secretary of a large non-listed company. Five years' experience as an internal auditor in a government parastatal. Member of the Institute of Internal Auditors.
Ashad Vialli	BA LLB MBA. Recently returned from a two year secondment to a large banking organisation in New York where he was involved in take-over financing and risk management. Meticulous in the presentation, flamboyant and charming. Very ambitious.
Jon Carstens	No formal qualification. 20 years' experience in internal audit. Very confident, to the extent that he does not value the opinion of others. Displays an attitude of "I've seen this all before."

Cameron King	Eight years being employed as a senior internal auditor at Dyson (Pty) Ltd. Regarded as a very hard worker and responsible individual. Generally very nervous when dealing with senior personnel. Has served on the Risk committee at Dyson (Pty) Ltd for two years, making a quiet but meaningful contribution.
Lance Carredo	A chartered accountant (CA), member of the Institute of Internal Auditors and part-time wildlife conservationist. Resigned from his previous appointment as an internal audit manager because of an alleged leak of information to the media about environmental damage caused by one of the divisions of the company where he conducted an environmental audit.
Justice Matese	A chartered accountant (CA) and member of the Institute of Internal Auditors. Currently an internal audit manager at a parastatal. Prior to that he had spent a number of years as an arbitrator in the labour market where he gained a reputation for his fair mindedness and hard work.
Scott Fines	A well-qualified computer systems analyst who had been responsible for most of the financial systems at Dyson (Pty) Ltd. As he has worked on computer systems throughout the company at some time or other, he is very well known by the staff. Very friendly and popular with everyone. Currently in the final year of his internal auditing studies and looking for a career change.

REQUIRED

Indicate for each of the applicants above, whether Floyd Mayweather is likely to consider the applicant as suitable for appointment, based on the information given above. Your answer should convey your understanding of the characteristics/attributes required of an internal auditor in this position.

(Source: adapted from Graded Questions 2015)

QUESTION 3

25 marks

The internal audit activity of Tshwane Ltd is due for its first external quality assurance review. You have been tasked with the responsibility to ensure that all the documentation is ready for the external service provider to review. The internal audit charter that was approved when the internal audit activity was established six years ago, reads as follows:

Charter

Internal Auditing Department

1. Introduction

Internal Auditing is an independent and objective assurance and consulting activity designed to add value and improve Tshwane Ltd's operations

2. Role

The board of directors establishes the internal auditing department, and its responsibilities are defined by the audit committee of the board of directors as part of its oversight function

3. Professional Standards

The internal auditing staff should perform their work professionally according to the universal auditing standards

4. Authority

Authority to access documents must be obtained at all times before an engagement is started, and no communication may take place without the CEO's specific agreement

Documents and information given to Internal Auditing during a periodic review, will be handled in the same prudent and confidential manner, as those employees who are normally accountable for them would

5. Organisation

The CAE shall report to the CEO administratively and functionally to the CFO

6. Independence

Internal audit shall remain free of influence by any element in the organisation, including matters of audit selection, scope, procedures, frequency, timing, or report content to permit maintenance of an independent and objective mental attitude necessary in rendering reports.

Internal auditors can be asked to assist with specific operational responsibilities when necessary.

7. Audit scope

The scope of internal auditing encompasses the examination and evaluation of any activity requested by the CEO when he regards such an activity due for an investigation

8. Audit planning

Annually, the CAE shall submit to senior management and the audit committee a summary of the audit work schedule, staffing plan, and budget for the following fiscal year. This will only be for information purposes and not for approval

9. Reporting

The CAE or designee will prepare and issue a written report following the conclusion of each audit and it will be distributed to the CEO only

Internal Auditing shall be responsible for appropriate follow-up on audit findings and recommendations when instructed by the Chief Financial Officer (CFO), after discussion with the CEO.

10. Periodic assessment

The CAE should periodically assess whether the purpose, authority and responsibility, as defined in this charter, continue to be adequate to enable the internal audit activity to accomplish its objectives. The results of this periodic assessment should be communicated to senior management

11. Approval

Signed CAE _____ CEO _____

REQUIRED

For **each** aspect addressed in the existing charter, numbered from 1 to 11

3.1 Indicate whether it complies with the Standards and the definition of internal auditing. (5)

3.2 Where necessary i.e. where **no** or **partial** compliance is indicated, change the wording to bring the existing charter in line with the Standards and the definition of internal auditing (20)

Structure your answer in the following format

Aspect	3.1 Comply (Yes/No/Partially)	3.2 Changes recommended
1	(½)	(1 mark per valid recommendation)
2		

QUESTION 4

12 Marks

The Chairperson of the audit committee approached the CAE and requested her to explain to the audit committee and the board of directors what combined assurance and integrated sustainability reporting mean and to indicate the role and responsibilities of the audit committee in this regard. The CAE asked you to assist her in drawing up the annual audit plan for All Yours Ltd for approval by the audit committee and to respond to their question on combined assurance and integrated sustainability reporting.

REQUIRED

- 4.1 Explain to the audit committee the meaning of integrated sustainability reporting (3)
- 4.2 Explain what is meant by combined assurance (2)
- 4.3 Indicate the role of the audit committee in the combined assurance model (2)
- 4.4 With reference to the International Standards for the Professional Practice of Internal Auditing (Standards) and the King Code of Governance for South Africa 2009 (King III), discuss the factors that the CAE should take into account when developing a risk-based audit plan (5)

Source: Adapted from Graded Questions on Auditing 2010

QUESTION 5

18 marks

You are preparing lectures for in-office training sessions for newly appointed internal auditor in the internal audit department. One of the lectures will cover the Code of Ethics. You need to explain the following to them:

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 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

REQUIRED

- 5.1 Explain the need for a Code of Ethics for Internal Auditors. Discuss **two** (2) aspects that you as the CAE will use to explain this to the new employees (4)
- 5.2 Name and describe the **principles** which the Code of Ethics are based on (6)
- 5.3 Illustrate how each principle may be contravened by describing a practical example where a related rule of conduct has been broken by an internal auditor (8)