

Sample Practice Questions, Answers, and Explanations

Domain 1: Managing the Internal Audit Function (40–50%)

1. The proper organizational role of internal auditing is to:

- a. Assist the external auditor in order to reduce external audit fees.

Incorrect. Reduction of external audit fees is a result of internal audit work but not a role.

- b. Perform studies to assist in the attainment of more efficient operations.

Incorrect. This does not represent a complete description of the proper role.

- c. Serve as the investigative arm of the audit committee of the board of directors.

Incorrect. This role is too limited for internal auditing. It also serves operations management and top management.

- d. **Serve as an appraisal function to examine and evaluate activities as a service to the organization.**

Correct. This alternative describes the basic role concept of internal auditing.

2. In some organizations, consideration is being given to the possibility of outsourcing internal audit functions. Management in a large organization should recognize that the external auditor might have an advantage, compared to the internal auditor, because of the external auditor's:

- a. Familiarity with the organization. Its annual audits provide an in-depth knowledge of the organization.

Incorrect. The internal audit staff, not the external auditor, through its continuous auditing, gains an in-depth knowledge of the organization.

- b. Size. It can hire experienced, knowledgeable, and certified staff.

Incorrect. The internal audit staff is able to maintain an experienced knowledgeable and certified (CIA) staff, without the potential threat of staff reassignment.

- c. Size. It is able to offer continuous availability of staff unaffected by other priorities.

Incorrect. The internal staff is continuously available and not subject to greater priority work with other clients.

- d. **Structure. It may more easily accommodate audit requirements in distant locations.**

Correct. The external auditor can offer better service in other geographical areas because of its dispersion of offices.

3. The status of the internal auditing function should be free from the impact of irresponsible policy changes by management. The most effective way to ensure that freedom is to:
 - a. **Have the internal auditing charter approved by both management and the board of directors.**
Correct. Approval of the charter by the board of directors will protect the internal auditing function from management actions, which could weaken the status of the internal auditing department.
 - b. Adopt policies for the functioning of the auditing department.
 Incorrect. While adoption of the *Standards* serves as a guide and a measure of internal auditing performance, it will not protect and preserve the department's status.
 - c. Establish an audit committee within the board of directors.
 Incorrect. The establishment of an audit committee does not ensure the status of internal auditing without its involvement in areas such as approval of the charter.
 - d. Develop written policies and procedures to serve as standards of performance for the department.
 Incorrect. Written policies and procedures serve to guide the audit staff but have little impact on management.
4. The consultative approach to auditing emphasizes:
 - a. Imposition of corrective measures.
 Incorrect. The word "imposition" implies an adversarial relationship.
 - b. **Participation with auditees to improve methods.**
Correct. Since auditors alone cannot implement audit recommendations, auditee participation and involvement makes improvements better.
 - c. Fraud investigation.
 Incorrect. Auditors, not consultants, investigate fraud.
 - d. Implementation of policies and procedures.
 Incorrect. Due to the requirement for independence, auditors should never implement policies and procedures.
5. In some cultures and organizations, managers insist that the internal auditing function is not needed to provide a critical assessment of the organization's operations. A management attitude such as this will most probably have an adverse effect on the internal auditing function's:
 - a. Operating budget variance.
 Incorrect. An operating budget variance report is a control device used to monitor actual performance versus budget. Management foot-dragging could cause unfavorable variances, but favorable variances could also occur if many audits were cut short due to scope impairments.
 - b. **Effectiveness.**
Correct. In this type of situation, management is highly averse to analysis or possible criticism of its actions and will inhibit the internal audit department's effectiveness.
 - c. Performance appraisals.
 Incorrect. An unbiased evaluation of audit staff would not be affected by lack of cooperation on the part of non-audit management.
 - d. Policies and procedures.
 Incorrect. Policies and procedures of the internal audit function are developed by the internal audit department and should not be affected by non-audit management.
6. As part of the process to improve auditor–auditee relations, it is very important to deal with how internal auditing is perceived. Certain types of attitudes in the work performed will help create these perceptions. From a management perspective, which attitude is likely to be the **most** conducive to a positive perception?
 - a. Objective.
 Incorrect. An objective attitude is desirable but by itself will not lead to a more positive relationship.
 - b. Investigative.
 Incorrect. An investigative attitude is not likely to enhance the relationship.
 - c. Interrogatory.
 Incorrect. An interrogatory attitude is not likely to enhance the relationship.
 - d. **Consultative.**
Correct. A consultative attitude leads to two-way communication.

7. In planning a system of internal operating controls, the role of the internal auditor is to:
- Design the controls.
Incorrect. This is a role of management.
 - Appraise the effectiveness of the controls.**
Correct. This is the proper role of the internal auditor, which is to report the results to management.
 - Establish the policies for controls.
Incorrect. This is a role of management.
 - Create the procedures for the planning process.
Incorrect. This is a role of management.
8. An audit committee should be designed to enhance the independence of both internal and external audit functions and to insulate the audit functions from undue management pressures. Using these criteria, audit committees should be composed of:
- A rotating subcommittee of the board of directors or its equivalent.
Incorrect. Rotating subcommittee members can be internal to a company and would not have independence.
 - Only members from the relevant outside regulatory agencies.
Incorrect. External members should represent different backgrounds, not just regulatory background.
 - Members from all important constituencies, specifically including representatives from banking, labor, regulatory agencies, shareholders, and officers.
Incorrect. The size of the audit committee is limited and cannot include too many people, such as representatives from shareholders and labor.
 - Only external members of the board of directors or its equivalent.**
Correct. Audit committees should be made up of external members of the board of directors or other similar oversight committees.
9. Accepting the concept that internal auditing should be an integral part of an organization can involve a major change of attitude on the part of top management. Which of the following would be the **best** way for internal auditors to convince management regarding the need for and benefits of internal auditing?
- Persuading top managers to accept the idea of internal audits by contacting company shareholders and regulatory agencies.
Incorrect. Manipulation is not an option since it can be done only if the party manipulating has power. Its effects are also short-lived and do not lead to long-term commitment.
 - Educating top managers about the benefits and communicating with them on a regular basis.**
Correct. Education and communication, although lengthy and costly, are the only way to achieve long-term results.
 - Negotiating with top management to provide them with rewards, such as favorable audits.
Incorrect. Negotiation is not an alternative since the two parties do not have equal power. Furthermore, internal auditors often do not have immediate rewards available to them to offer management.
 - Involving top management in deciding which audit findings will be reported.
Incorrect. Involving top management in this manner is not appropriate.
10. Which of the following features of a large manufacturing company's organization structure would be a control weakness?
- The IT department is headed by a vice president who reports directly to the president.
Incorrect. This is a strength since it prevents the information technology operation from being dominated by a user.
 - The chief financial officer is a vice president who reports to the chief executive officer.
Incorrect. This is a strength since it prevents the information technology operation from being dominated by a user.
 - The audit committee of the board consists of the chief executive officer, the chief financial officer, and a major stockholder.**
Correct. The audit committee should be made up of independent directors.
 - The controller and treasurer report to the chief financial officer.
Incorrect. This is a strength since it prevents the information technology operation from being dominated by a user.

11. Audit committees have been identified as a major factor in promoting independence of both the internal and external auditor. Which of the following is the **most** important limitation on the effectiveness of audit committees?
- a. **Audit committees may be composed of independent directors. However, those directors may have close personal and professional friendships with management.**
Correct. This is a major limitation that has hampered the effective operation of audit committees.
- b. Audit committee members are compensated by the organization and thus favor a stockholder's view.
 Incorrect. Audit committee members are usually outside directors. Many of these directors have a broad viewpoint and are not limited to a stockholder's view.
- c. Audit committees devote most of their efforts to external audit concerns and do not pay much attention to internal auditing and the overall control environment.
 Incorrect. Audit committees devote considerable time to the external audit function, but the evidence is that they are increasingly devoting time to internal audit reports.
- d. Audit committee members do not normally have degrees in the accounting or auditing fields.
 Incorrect. A committee member need not have an accounting degree to understand most reporting and control issues.
12. Purchases from two new vendors increased dramatically after a new buyer was hired. The buyer was obtaining kickbacks from the two vendors based on sales volume. A possible means of detection is:
- a. Periodic vendor surveys regarding potential buyer conflict-of-interest or ethics violations.
 Incorrect. If the vendor was in collusion with the buyer, either no response or an incorrect response would be elicited.
- b. The receipt of an invoice to put new vendors on the master file.
 Incorrect. If collusion exists, the purchasing agent can arrange for the invoice.
- c. The use of purchase orders for all purchases.
 Incorrect. If collusion exists, the purchasing agent can arrange for the purchase order.
- d. **The use of change analysis and trend analysis of buyer or vendor activity.**
Correct. This is an example of analytical procedures to detect patterns and trends.
13. Due to the small staff, one remote unit's petty cash custodian also had responsibility for the imprest fund checking account reconciliation. The cashier concealed a diversion of funds by altering the beginning balance on the monthly reconciliations sent to the group office. A possible audit test to detect this would be to:
- a. **Compare monthly balances and use change and trend analysis.**
Correct. Verifying the beginning balance one month to the ending balance of the prior month is a good quick-change analysis that would catch this diversion.
- b. Require additional monitoring by headquarters whenever improper segregation of duties exists at remote units.
 Incorrect. This is not always possible or desired and not necessarily cost justified.
- c. Determine if any employees have high personal debt.
 Incorrect. Rumors as to personal finances may be unfounded, and they may be illegal to check out without the employee's knowledge.
- d. Determine if any employees are leading expensive lifestyles.
 Incorrect. Rumors as to personal finances may be unfounded, and they may be illegal to check out without the employee's knowledge.
14. In an organization that has a separate division that is primarily responsible for fraud deterrence, the internal auditing department is responsible for:
- a. **Examining and evaluating the adequacy and effectiveness of that division's actions taken to deter fraud.**
Correct. Control is the principal mechanism for the deterrence of fraud. Management, in turn, is primarily responsible for the establishment and maintenance of control. Internal auditors are primarily responsible for the examination and evaluation of the adequacy and effectiveness of actions taken by management in the fulfillment of their obligation.
- b. Establishing and maintaining that division's system of internal controls.
 Incorrect. Establishing the system of internal controls for an operating division is a management responsibility.
- c. Planning that division's fraud deterrence activities.
 Incorrect. The planning and execution of an operating division's activities are the responsibility of management.
- d. Controlling that division's fraud deterrence activities.
 Incorrect. Management is primarily responsible for the establishment and maintenance of control.

15. During the audit of payments under a construction contract with a local firm, the auditor finds a \$900 recurring monthly reimbursement for rent at a local apartment complex. Each reimbursement is authorized by the same project engineer. The auditor finds no provision for payment of temporary living expenses in the construction contract. Discussion with the project engineer could not resolve the matter. The auditor should:
- a. **Inform the audit director.**
Correct. The audit director should be informed before pursuing potential fraud.
- b. Call the engineer into a private meeting to confront the situation.
Incorrect. The project engineer has already been asked about the facts and did not resolve the issue.
- c. Complete the audit as scheduled, noting the \$900 recurring reimbursement in the working papers.
Incorrect. The unexplained payment may be an indicator of fraud.
- d. Wait until the engineer is surrounded by plenty of witnesses and then inquire about the payments.
Incorrect. Raising this issue in public may expose the auditor to liability for slander.
16. In the course of performing an audit, an internal auditor becomes aware of illegal acts being performed by several of the highest-ranking officers of the company. To whom should the findings of the audit report be addressed?
- a. Line-level supervision.
Incorrect. The auditees at the line level are not in a position to take corrective action. Disclosing sensitive information to this level also creates a situation where rumors can act to the detriment of the company.
- b. Members of the news media.
Incorrect. The internal auditor owes loyalty to the company that employs him or her. This obligation includes maintaining confidentiality of potentially damaging information that is under investigation.
- c. The officers involved in the illegal acts.
Incorrect. Confronting the implicated officers with the full findings only serves to give them time to hide their misdeeds while other responsibility levels are being notified.
- d. **The audit committee of the board of directors.**
Correct. The audit committee of the board of directors is independent of management and should be notified of the illegal acts of the senior management members.
17. Which of the following ensures that all inventory shipments are billed to customers?
- a. **Shipping documents are prenumbered and are independently accounted for and matched to sales invoices.**
Correct. This procedure will provide assurance that all shipments are invoiced.
- b. Sales invoices are prenumbered and are independently accounted for and traced to the sales journal.
Incorrect. This procedure ensures that sales invoices are recorded, not that those shipments are invoiced.
- c. Duties for recording sales transactions and maintaining customer account balances are separated.
Incorrect. This procedure provides no assurance that shipments are invoiced.
- d. Customer billing complaints are investigated by the controller's office.
Incorrect. Customers who are not billed for a delivery may not notify the company.

18. An auditor for a large service company is performing an audit of the company's cash balance. The auditor is considering the most appropriate audit procedure to use to ensure that the amount of cash is accurately recorded on the company's financial statements. The most appropriate audit procedures for the objective are:

- a. Review collection procedures and perform an analytical review of accounts receivable; confirm balances of accounts receivable; and verify the existence of appropriate procedures and facilities.

Incorrect. Audit procedures consisting of reviewing collection procedures, performing an analytical review of accounts receivable, confirming balances of accounts receivable, and verifying the existence of appropriate procedures and facilities would be appropriate for the objective of ensuring that all cash due is received. However, these audit procedures would be inappropriate for ensuring that the amount of cash was accurately recorded on the company's financial statements.

- b. Compare cash receipt lists to the receipts journal and bank deposit slips; review the segregation of duties; observe and test cash receipts.

Incorrect. Comparing cash receipt lists to the receipts journal and bank deposit slips, reviewing the segregation of duties, observing, and testing cash receipts would be appropriate audit procedures to satisfy the objective of safeguarding cash receipts. However, these audit procedures would be inappropriate for ensuring that the amount of cash was accurately recorded on the company's financial statements.

- c. Review the organizational structure and functional responsibilities; and verify the existence and describe protection procedures for unused checks, including security measures.

Incorrect. Reviewing the organizational structure and functional responsibilities; and verifying the existence and describing protection procedures for unused checks, including security measures, would be appropriate audit procedures to achieve the objective of ensuring that appropriate safeguards are in place to protect cash. However, these audit procedures would be inappropriate for ensuring that the amount of cash was accurately recorded on the company's financial statements.

- d. **Examine bank statement reconciliations, confirm bank balances, and verify cutoff of receipts and disbursements; foot totals of reconciliations and compare to cash account balances.**

Correct. Examining bank statement reconciliations, confirming bank balances, verifying cutoff of receipts and disbursements, footing totals, and comparing cash account balances would be appropriate audit procedures to achieve the objective of ensuring that the amount of cash was accurately recorded on the company's financial statements.

19. An internal auditor found that the supervisor does not properly approve employee time cards in one department. Which of the following could result?

- a. Duplicate paychecks might be issued.

Incorrect. Failing to approve time cards would not result in duplicate paychecks.

- b. The wrong hourly rate could be used to calculate gross pay.

Incorrect. This may result if the hourly rates used to calculate pay are not matched to personnel records.

- c. **Employees might be paid for hours they did not work.**

Correct. This would decrease the chances of discovering employees who entered hours they did not work on their time cards.

- d. Payroll checks might not be distributed to the appropriate payees.

Incorrect. This could be prevented by positively identifying paycheck recipients.

20. Which of the following controls would **most** likely minimize defects in finished goods due to poor-quality raw materials?

- a. Proper handling of work-in-process inventory to prevent damage.

Incorrect. This would not ensure that raw materials are of sufficient quality.

- b. **Implementation of specifications for purchases.**

Correct. Specifications for materials purchased provide an objective means of determining that the materials meet the minimum quality level required for production.

- c. Timely follow-up on unfavorable usage variances.

Incorrect. This would only help ensure that raw materials are used in the proper quantities.

- d. Determination of spoilage at the end of the manufacturing process.

Incorrect. This would only permit proper determination of spoilage after raw materials have been used in production.

21. Which of the following is an appropriate audit procedure when testing payroll in a company with a satisfactory internal control environment?
- a. Selectively interviewing a sample of employees.
Incorrect. Employees normally have no direct knowledge of the payroll cycle or entries.
- b. **Examining time cards or time sheets for proper approval.**
Correct. Supervisory review and approval of employees' time records is essential in a properly functioning internal control environment to provide assurance of employee time worked.
- c. Sending confirmation letters to government authorities.
Incorrect. Government authorities will not normally provide such confirmation. It is the employers' responsibility to ensure accuracy.
- d. Verifying all payroll calculations for one pay cycle.
Incorrect. If controls were to be relied on, it would be more appropriate to test to ensure supervisory initials as evidence of control rather than to recalculate.
22. Which of the following means would be the **most** appropriate to minimize the risk of a company's buyer purchasing from a vendor who is a relative?
- a. Establish a purchasing economic order quantity.
Incorrect. This procedure will control the quantity ordered but will not control the vendor.
- b. Establish a predetermined reorder point for purchases.
Incorrect. This procedure will help to ensure the maintenance of sufficient quantity on hand but will not control the vendor.
- c. **Maintain an approved-vendor file for purchases.**
Correct. This procedure will help to ensure that purchases are made only from approved vendors.
- d. Perform a risk analysis for the purchasing function.
Incorrect. This procedure will help to identify and evaluate the risks involved in the purchasing function but will not control the vendor.
23. The president wants to know whether the purchasing function is properly meeting its charge to purchase the right material at the right time in the right quantities. Which of the following types of audits addresses the president's request?
- a. A financial audit of the purchasing department.
Incorrect. This type of audit deals almost exclusively with the financial and accounting aspects of operations.
- b. **An operational audit of the purchasing function.**
Correct. An operational audit would address the effectiveness, efficiency, and economy of the entire purchasing operation. This is what the president has requested.
- c. A compliance audit of the purchasing function.
Incorrect. This type of audit deals almost exclusively with compliance matters.
- d. A full-scope audit of the manufacturing operation.
Incorrect. Such an audit would deal with financial, compliance, and operational aspects of the whole manufacturing operation. This goes beyond the president's request.
24. Which account balance is **most** likely to be misstated if an aging of accounts receivable is not performed?
- a. Sales revenue.
Incorrect. Aging accounts receivable would provide no information on sales revenue.
- b. Sales returns and allowances.
Incorrect. The balance of the sale returns and allowance account is determined by actual returns and allowance, not by the age of accounts receivable.
- c. Accounts receivable.
Incorrect. The balance of the accounts receivable account is not affected by the age of accounts receivable.
- d. **Allowance for bad debts.**
Correct. The allowance for bad debts is determined based on the probability of collecting accounts receivable. The age of an account is a major determinant of its collectibility.

25. An internal audit of payroll would **least** likely include:

- a. Tests of computations for gross and net wages.
Incorrect. This choice is a routine procedure.
- b. Comparison of payroll costs to budget.
Incorrect. This choice is a routine procedure.
- c. Tracing a sample of employee names to employment records in the personnel department.
Incorrect. This choice is a routine procedure.

d. Observing the physical distribution of paychecks.

Correct. Most companies large enough to have internal auditing do not physically distribute paychecks on a regular basis. Moreover, this is generally regarded as an extended procedure most applicable to fraud audits.

26. In response to a confirmation of the June 30 accounts receivable balances, a customer reported that the balance confirmed had been paid by a check dated and mailed June 20. The auditor reviewed the postings of cash receipts in July and found the payment had been recorded on July 13. Given this information, the next audit action should be to:

- a. Require an adjusting entry to the payment to June.
Incorrect. The issue concerns the late deposit, not adjusting the receipt.

b. Compare deposit slips to posting records.

Correct. Determine if the check was deposited but the posting was delayed. This is an indication of lapping.

- c. Trace the billing invoice to the related shipping documents and inventory records, comparing dates "shipped" to "billed" to determine proper period.
Incorrect. This test deals with late billing, not late posting of receipts.
- d. Request a bank cutoff statement for July and reconcile the June deposits in transit and outstanding checks by examining supporting documentation.
Incorrect. This procedure would reconcile bank and book records; the issue is the possible delay in posting the receipt.

27. The scope of work in developing and maintaining a quality assurance and improvement program (QAIP) includes which of the following processes?

- I. Supervision.
- II. Internal assessment.
- III. Ongoing monitoring.
- IV. External assessment.

a. I only.

Incorrect. This is not the most complete answer.

b. I and II.

Incorrect. This is not the most complete answer.

c. I, II, and III.

Incorrect. This is not the most complete answer.

d. I, II, III, and IV.

Correct. The chief audit executive is accountable for implementing processes and QAIP designed to provide reasonable assurance to the various stakeholders that the internal audit activity. These processes include appropriate supervision, periodic internal assessments and ongoing monitoring of quality assurance, and periodic external assessments.

28. Which of the following is **not** included in the ongoing and periodic assessment containing measurements and analyses of performance metrics with respect to internal audit's quality assurance and improvement program (QAIP)?

a. Money saved from the audit work.

Correct. A QAIP is an ongoing and periodic assessment of the entire spectrum of audit and consulting work performed by the internal audit activity. This periodic assessment includes ongoing measurements and analyses of performance metrics (e.g., internal audit plan accomplishment, cycle time, recommendations accepted, and customer satisfaction). Although an objective measure, money saved from the audit work is not useful due to difficulties in quantifying savings and problems in agreement with the auditees and organization's management.

b. Number of recommendations accepted.

Incorrect. See correct answer (a).

c. Customer satisfaction.

Incorrect. See correct answer (a).

d. Audit cycle time.

Incorrect. See correct answer (a).

29. If the results of the assessment of the internal audit's quality assurance and improvement program (QAIP) indicate areas for improvement, which of the following will implement such improvements?
- a. Audit committee of the board.
Incorrect. See correct answer (b).
 - b. Chief audit executive.
Correct. A QAIP is an ongoing and periodic assessment of the entire spectrum of audit and consulting work performed by the internal audit activity. If results of the assessments indicate areas for improvement by the internal audit activity, the chief audit executive will implement the improvements through the QAIP.
 - c. Chief executive officer.
Incorrect. See correct answer (b).
 - d. External auditor.
Incorrect. See correct answer (b).
30. All of the following stakeholders receive the results of internal and external quality program assessment of internal audit's activity from the chief audit executive (CAE) **except**:
- a. Functional managers.
Correct. Functional managers need not to know these results because there are too many of them to distribute material to and because the scope of the quality program affects the entire organization, not just their individual business function. To provide accountability and transparency, the CAE communicates the results of external and, as appropriate, internal quality program assessments to the various stakeholders of the activity (such as senior management, the board, and external auditors).
 - b. Senior managers.
Incorrect. At least annually, the CAE reports to senior management on the quality program efforts and results.
 - c. Board of directors.
Incorrect. At least annually, the CAE reports to the board of directors on the quality program efforts and results.
 - d. External auditor.
Incorrect. See correct answer (a).
31. Which of the following is unique to the external assessment of an internal audit's activity when compared to internal assessment?
- a. Findings.
Incorrect. Findings are common with internal assessments.
 - b. Conclusions.
Incorrect. Conclusions are common with internal assessments.
 - c. Recommendations.
Incorrect. Recommendations are common with internal assessments.
 - d. Overall opinion.
Correct. External assessments of an internal audit activity contain an expressed opinion as to the entire spectrum of assurance and consulting work performed (or that should have been performed based on the internal audit charter) by the internal audit activity, including its conformance with the definition of internal auditing, the Code of Ethics, and the Standards and, as appropriate, includes recommendations for improvement.
32. Which of the following is unique to the external assessment of an internal audit's activity when compared to internal assessment?
- a. Follow-up.
Incorrect. Follow-up is common with internal assessments.
 - b. Findings.
Incorrect. Findings are common with internal assessments.
 - c. Responses from the chief audit executive.
Correct. Receiving written responses from the chief audit executive (CAE) that include an action plan and implementation dates is unique to the external assessments. Here the CAE assumes the auditee role and the external assessor assumes the auditor role.
 - d. Recommendations.
Incorrect. Recommendations are common with internal assessments.

33. Which of the following facilitates and reduces the cost of the external assessment of an internal audit's activity?

- a. **A periodic internal assessment performed within a short time before an external assessment.**

Correct. A periodic internal assessment performed within a short time before an external assessment can serve to facilitate and reduce the cost of the external assessment.

- b. A periodic internal assessment performed in parallel with an external assessment.

Incorrect. See correct answer (a).

- c. A periodic internal assessment performed within a long time before an external assessment.

Incorrect. See correct answer (a).

- d. A periodic internal assessment performed within a short time after an external assessment.

Incorrect. See correct answer (a).

34. Which of the following is unique to ongoing internal assessment of an internal audit's activity?

- a. Best practices.

Incorrect. Best practices are common to both internal assessment and external assessments.

- b. **Cost recoveries.**

Correct. The processes and tools used in ongoing internal assessments include project budgets, timekeeping systems, audit plan completion, and cost recoveries, among others.

- c. Benchmarking.

Incorrect. Benchmarking is common to both internal assessment and external assessments.

- d. Expected deliverables.

Incorrect. See correct answer (b).

35. Which of the following is unique to external assessment of an internal audit's activity?

- a. Best practices.

Incorrect. Best practices are common to both internal assessment and external assessments.

- b. Cost recoveries.

Incorrect. Cost recoveries are used in internal assessments.

- c. Benchmarking.

Incorrect. Benchmarking is common to both internal assessment and external assessments.

- d. **Expected deliverables.**

Correct. The chief audit executive is to ensure the scope clearly states the expected deliverables of the external assessment in each case.

36. Which of the following is common between internal assessment and external assessment of an internal audit's activity?

- a. **Audit Standards.**

Correct. By definition, the scope of external assessment is broader than that of internal assessment. However, Audit Standards are common to both of them.

- b. Audit charter.

Incorrect. Review of the audit charter is part of the external assessment, not part of the internal assessment.

- c. Code of Ethics.

Incorrect. Review of the Code of Ethics is part of the external assessment, not part of the internal assessment.

- d. Definition of internal auditing.

Incorrect. The definition of internal auditing is part of the external assessment, not part of the internal assessment.

37. The scope of external assessment of an internal audit's activity should not be limited to which of the following?

- a. Assurance services.

Incorrect. See correct answer (d)

- b. Consulting services.

Incorrect. See correct answer (d)

- c. Leading practices.

Incorrect. See correct answer (d)

- d. **Quality assurance and improvement program.**

Correct. External assessments cover the entire spectrum of audit and consulting work performed by the internal audit activity and should not be limited to assessing its quality assurance and improvement program. To achieve optimum benefits from an external assessment, the scope of work should include benchmarking, identification, and reporting of leading practices that could assist the internal audit activity in becoming more efficient and/or effective.

38. Which of the following can be used by an independent external reviewer when establishing the scope of the external assessment of an internal audit's activity?

- a. Percentage of audit plan completed in a year by the internal audit.

Incorrect. This choice is targeted at auditees and internal audit management. It is a routine task but does not focus on the big picture of the assessment of the internal audit's activity.

- b. Number of findings reported in a year by the internal audit.

Incorrect. This choice is targeted at auditees and internal audit management. It is a routine task but does not focus on the big picture of the assessment of the internal audit's activity.

- c. Percentage of quality assurance and improvement program (QAIP) implemented by the internal audit.

Correct. Internal auditors are required to do a full self-assessment of QAIP. Failure of internal auditors to do this full assessment will send a red flag to the external assessors. Assessment of QAIP is common between internal assessments and external assessments. The QAIP assesses the efficiency and effectiveness of the internal audit's activity and identifies opportunities for improvement. Since the QAIP is a part of internal audit Standards, its conformity is very important which will decide the breadth and depth of the external assessment's scope of work.

- d. Number of audit recommendations accepted in a year by the auditees.

Incorrect. This choice is targeted at auditees and internal audit management. It is a routine task but does not focus on the big picture of the assessment of the internal audit's activity.

39. What should the audit strategy be?

- a. It should be knowledge based.

Incorrect. It does not consider risk as explicitly as the correct choice.

- b. It should be cycle based.

Incorrect. It does not consider risk as explicitly as the correct choice.

- c. It should be request based.

Incorrect. It does not consider risk as explicitly as the correct choice.

- d. It should be risk based.

Correct. Audits should be planned and conducted according to the risk level; that is, high-risk auditable areas should be reviewed first, followed by medium-risk areas, which are followed by low-risk areas. The medium- and low-risk auditable areas should be reviewed only when audit resources are available.

40. Which one of the following items includes the other three items?

- a. Inherent risk.

Incorrect. Inherent risk is the susceptibility of a management assertion to a material misstatement, assuming that there are no related internal control structure policies or procedures.

- b. Control risk.

Incorrect. Control risk is the risk that a material misstatement in a management assertion will not be prevented or detected on a timely basis by the entity's internal control structure policies or procedures.

- c. Audit risk.

Correct. Audit risk is the risk that the auditor may unknowingly fail to appropriately modify his or her opinion on financial statements that are materially misstated. It is the product of the other three risks: It is equal to inherent risk multiplied by control risk, which is multiplied by detection risk. "Audit risk" is an all-inclusive term here.

- d. Detection risk.

Incorrect. Detection risk is the risk that the auditor will not detect a material misstatement present in a management assertion.

41. Which of the following would **not** be considered in performing a risk analysis exercise?

a. System complexity.

Incorrect. This is considered in performing a risk analysis exercise.

b. Results of prior audits.

Incorrect. These are considered in performing a risk analysis exercise.

c. Auditor skills.

Correct. Auditor skills become a consideration during audit scheduling. Risk analysis is done prior to the start of an audit, where factors such as system complexity, system changes, and results of prior audit are very important to consider. These factors determine whether an audit-able area is high risk, medium risk, or low risk.

d. System changes.

Incorrect. These are considered in performing a risk analysis exercise.

42. Management is concerned with a recent increase in expenditures and lower profits at a division and has asked the internal audit department to perform an operational audit of the division. Management would like to have the audit completed as quickly as possible and has asked the internal audit department to allocate all possible resources to the task. The director of internal audit is concerned with the time pressure since the internal audit department is heavily involved in a major legal compliance audit that had been requested by the audit committee. Which of the following comments are correct regarding the assessment of risk associated with the two projects?

I. Activities requested by the audit committee should always be considered higher risk than those requested by management.

II. Activities with higher dollar budgets should always be considered higher risk than those with lower dollar budgets.

III. Risk should always be measured by the potential dollar or adverse exposure to the organization.

a. I only.

Incorrect. Requests from management and the audit committee should both be considered by the internal audit department. Although an audit committee request is important, it is not always more important, nor does it always imply higher risk (item I).

b. II only.

Incorrect. Risk is measured by the potential exposure to the organization. The size of the departmental budget is an important determinant, but is not a sufficient determinant (item II).

c. III only.

Correct. This is the basic definition of risk given in the IIA Standards (item III).

d. I and III.

Incorrect. It contains both correct and incorrect answers.

43. Risk models or risk analysis is often used in conjunction with development of long-range audit schedules. The key input in the evaluation of risk is:
- Previous audit results.
Incorrect. The informed judgment of the internal auditor is still required to assess the magnitude of risk posed by previous audit results.
 - Management concerns and preferences.
Incorrect. To assess the risk posed by management concerns, informed judgment of the internal auditor is required.
 - Specific requirements of the *Standards*.
Incorrect. The *Standards* do not specify the basic input risk analyses.
 - Judgment of the internal auditor.**
Correct. In assessing the magnitude of risk associated with any factor in a risk model, informed judgment by the auditor is required.
44. Directors may use a tool called risk analysis in preparing work schedules. Which of the following would **not** be considered in performing a risk analysis?
- Financial exposure and potential loss.
Incorrect. These factors should definitely be considered in risk analysis.
 - Skills available on the audit staff.**
Correct. This does not involve risk associated with potential auditees.
 - Results of prior audits.
Incorrect. These factors should definitely be considered in risk analysis.
 - Major operating changes.
Incorrect. These factors should definitely be considered in risk analysis.
45. Factors that should be considered when evaluating audit risk in a functional area include:
- Volume of transactions.
 - Degree of system integration.
 - Years since last audit.
 - Significant management turnover.
 - (Dollar) value of "assets at risk."
 - Average value per transaction.
 - Results of last audit.
- Factors that **best** define materiality of audit risk are:
- 1 through 7.
Incorrect. Although all items are used to define audit risk, not all factors are used to define materiality of audit risk.
 - 2, 4, and 7.
Incorrect. Factors 2 and 4 cannot be quantified into materiality.
 - 1, 5, and 6.**
Correct. Factors 1, 5, and 6 can all be quantified into values, which can be measured into materiality.
 - 3, 4, and 6.
Incorrect. Factors 3 and 4 cannot be quantified into materiality.
46. In an audit of a purchasing department, which of the following generally would be considered a risk factor?
- Purchase specifications are developed by the department requesting the material.
Incorrect. It is a normal procedure; purchasing reviews the specifications only.
 - Purchases are made against blanket or open purchase orders for certain types of items.
Incorrect. It is normal procedure for high-use items.
 - Purchases are made from parties related to buyers or other company officials.**
Correct. This invariably involves high risk.
 - There is a failure to rotate purchases among suppliers included on an approved vendor list.
Incorrect. An approved vendor list is often maintained as a control factor to help ensure that purchases are made only from reliable vendors. However, rotation is not usually appropriate.

Domain 2: Managing Individual Engagements (40–50%)

1. During a preliminary survey, an auditor notes that several accounts payable vouchers for major suppliers show adjustments for duplicate payment of prior invoices. This would indicate:

- a. **A need for additional testing to determine related controls and the current exposure to duplicate payments made to suppliers.**

Correct. A preliminary survey is a process used to become familiar with activities and risks in order to identify areas for audit emphasis. This preliminary survey information should prompt the auditor to identify the magnitude of such duplicate payments.

- b. An unrecorded liability for the amount of purchases that are not processed while awaiting supplier master file address maintenance.

Incorrect. This situation is not identified in the question.

- c. A lack of control in the receiving area that prevents timely notice to the accounts payable area that goods have been received and inspected.

Incorrect. The existence of duplicate payments is not related to a problem in the receiving area.

- d. The existence of a sophisticated accounts payable system that correlates overpayments to open invoices and therefore requires no further audit concern.

Incorrect. Duplicate payments are not overpayments; they are exceptions and should be handled as such.

2. Writing an audit program occurs at which stage of the audit process?

- a. **During the planning stage.**

Correct. Planning should include writing the audit program.

- b. Subsequent to testing internal controls to determine whether to rely on the controls or audit around them.

Incorrect. The external auditor may use this approach in designing substantive tests of balances. (AICPA SAS 55).

- c. As the audit is performed.

Incorrect. The program is prepared in advance and modified, as appropriate, during the course of the audit.

- d. At the end of each audit, the standard audit program should be revised for the next audit to ensure coverage of noted problem areas.

Incorrect. While this choice could be done, the program should be updated during the planning process.

3. In planning an audit, an on-site survey could assist with all of the following **except**:

- a. Obtaining auditee comments and suggestions on control problems.

Incorrect. Survey would assist in obtaining auditee comments.

- b. Obtaining preliminary information on internal controls.

Incorrect. Survey would assist in obtaining information on internal controls.

- c. Identifying areas for audit emphasis.

Incorrect. Survey would assist in identifying areas for audit emphasis.

- d. **Evaluating the effectiveness of the system of internal controls.**

Correct. Determining the effectiveness of internal controls would require testing.

4. Which of the following is a proper step in an audit program?

- a. Notification of the audit.

Incorrect. This action is taken prior to the development of an audit program. It is done during audit planning.

- b. **Observation of procedures.**

Correct. Techniques such as observation and inspection are part of an audit program, which describes specific actions (steps) to be taken by the auditor.

- c. Definition of audit objectives.

Incorrect. This action is taken prior to the development of an audit program. It is done during audit planning.

- d. Planning for audit reporting.

Incorrect. This action is taken prior to the development of an audit program. It is done during audit planning.

5. "Fieldwork" has been defined as "a systematic process of objectively gathering evidence about an entity's operations, evaluating it, and determining if those operations meet acceptable standards." Which of the following is **not** part of the work performed during fieldwork?
- a. Expanding or altering audit procedures if circumstances warrant.
Incorrect. This is a requirement of the *Standards* that relates to fieldwork.
 - b. Applying the audit program to accomplish audit objectives.
Incorrect. This statement concerning fieldwork is true, and it is in harmony with the *Standards*.
 - c. Creating working papers that document the audit.
Incorrect. Working paper preparation is a requirement of IIA *Standards*, which should be met during fieldwork.
 - d. **Developing a written audit program.**
Correct. This is a requirement of the audit-planning *Standard*. The audit program should be developed before the fieldwork begins.
6. IIA *Standards* require auditors to discuss conclusions and recommendations at appropriate levels of management before issuing final written reports. Auditors usually accomplish this by conducting exit conferences. Which of the following **best** describes the purpose of exit conferences?
- a. To allow auditees to get started implementing recommendations as soon as possible.
Incorrect. This is a secondary benefit of exit conferences.
 - b. To allow auditors to explain complicated findings before a written report is issued.
Incorrect. Complicated findings must be explained thoroughly in written reports.
 - c. To allow auditors to "sell" findings and recommendations to management.
Incorrect. This is a secondary benefit of exit conferences.
 - d. **To ensure that there have been no misunderstandings or misinterpretations of facts.**
Correct. The major purpose of an exit conference is to discuss problems, conclusions, and recommendations and to ensure that there have been no misunderstandings or misinterpretations of facts. This is the primary purpose of exit conferences.
7. In the preparation of an audit program, which of the following items is **not** essential?
- a. Performance of a preliminary survey.
Incorrect. It is needed to determine audit objectives and controls in use.
 - b. Review of material from prior audit reports.
Incorrect. This is done to get background on the audit.
 - c. **Preparation of a budget identifying the costs of resources needed.**
Correct. Resources to be used is necessary. However, conversion to costs needed is not essential for the program.
 - d. Review of performance standards set by management.
Incorrect. This refers to obtaining information on the validity of criteria to be used or to be evaluated during the audit.
8. What action should an internal auditor take on discovering that an audit area was omitted from the audit program?
- a. Document the problem in the working papers and take no further action until instructed to do so.
Incorrect. Although the finding should be documented, it should be determined whether any changes may need to be made to the audit plan.
 - b. Perform the additional work needed without regard to the added time required to complete the audit.
Incorrect. The budgeted hours should be reviewed and increases approved prior to undertaking any additional steps.
 - c. Continue the audit as planned and include the unforeseen problem in a subsequent audit.
Incorrect. The unforeseen area may have an impact on the planned audit and need to be incorporated into the plan.
 - d. **Evaluate whether completion of the audit as planned will be adequate.**
Correct. Changes are often needed in the audit plan as work progresses. The auditor should review the plan with his or her supervisor since revised budgets may be needed.

9. In order to determine the extent of audit tests to be performed during fieldwork, preparing the audit program should be the next step after completing the:
- Preliminary survey.**
Correct. During the preliminary survey, the internal auditor becomes acquainted with the auditee and decides how much reliance he can place on the internal control system. This allows the auditor to initially determine whether to extend or limit audit tests. The auditor then prepares the audit program.
 - Survey of company policies.
Incorrect. The survey of company policies may be a segment of the preliminary survey. However, completing the survey of company policies is not sufficient to begin preparing the audit program; the entire preliminary survey must be completed.
 - Assignment of audit staff.
Incorrect. Audit staff are usually assigned to specific assignments before completing either the preliminary survey or the audit program.
 - Time budgets for specific audit tasks.
Incorrect. Specific tasks to be performed are determined during the audit program preparation.
10. Which of the following is a step in an audit program?
- The audit will commence in six weeks and include tests of compliance.
Incorrect. This is simply the proposed starting time and partial scope.
 - Determine whether the manufacturing operations are effective and efficient.
Incorrect. This is an audit objective.
 - Auditors may not reveal findings to nonsupervisory, operational personnel during the course of this audit.
Incorrect. This is a rule for the conduct of the audit personnel.
 - Observe the procedures used to identify defective units produced.**
Correct. This is an audit step because it is a procedure to be followed to obtain necessary evidence.
11. Audit programs testing internal controls should:
- Be tailored for the audit of each operation.**
Correct. A tailor-made program will be more relevant to an operation than a generalized program.
 - Be generalized to fit all situations without regard to departmental lines.
Incorrect. A generalized program cannot take into account variations resulting from changing circumstances and varied conditions.
 - Be generalized so as to be usable at all locations of a particular department.
Incorrect. A generalized program cannot take into account variations resulting from changing circumstances and varied conditions.
 - Reduce costly duplication of effort by ensuring that every aspect of an operation is examined.
Incorrect. Every aspect of an operation need not be examined—only those likely to conceal problems and difficulties.
12. An auditor begins an audit with a preliminary evaluation of internal control, the purpose of which is to decide on the extent of future auditing activities. If the auditor's preliminary evaluation of internal control results in a finding that controls may be inadequate, the next step would be:
- An expansion of audit work prior to the preparation of an audit report.**
Correct. If the preliminary findings indicate control problems, the auditor usually decides to do some expanded testing.
 - The preparation of a flowchart depicting the internal control system.
Incorrect. If a flowchart were necessary, the auditor would have prepared one during the preliminary evaluation.
 - An exception noted in the audit report if losses have occurred.
Incorrect. The auditor is not ready to make a report until more work has been performed.
 - To implement the desired controls.
Incorrect. Auditors do not implement controls; that is a function of management.

13. An internal auditor has just completed an on-site survey in order to become familiar with the company's payroll operations. Which of the following should be performed next?
- a. Assign audit personnel.
Incorrect. Audit personnel are normally assigned before the on-site survey takes place.
- b. Establish initial audit objectives.
Incorrect. Initial audit objectives are established at the beginning of the planning process. They should be specified before the on-site survey takes place.
- c. Write the audit program.
Correct. The audit program is normally prepared after the on-site survey. The on-site survey allows the auditor to become familiar with the auditee, and thus provides input to the audit program.
- d. Conduct fieldwork.
Incorrect. Fieldwork can be performed only after the audit program has been written. Thus, fieldwork could not immediately follow the on-site survey.
14. Interviewing operating personnel, identifying the objectives of the auditee, identifying standards used to evaluate performance, and assessing the risks inherent in the auditee's operations are activities typically performed in which phase of an internal audit?
- a. The fieldwork phase.
Incorrect. The activities described must be performed before the audit program can be developed, the fieldwork completed, or reporting can be undertaken.
- b. The preliminary survey phase.
Correct. These activities are normally accomplished during the preliminary survey phase
- c. The audit programming phase.
Incorrect. The activities described must be performed before the audit programming phase.
- d. The reporting phase.
Incorrect. The reporting phase is the last phase of the four choices given, hence it comes after the preliminary survey phase.
15. The auditor in charge has just been informed of the next audit assignment and the assigned audit team. Select the appropriate phase for finalizing the audit time budget.
- a. During formulation of the long-range plan.
Incorrect. An initial budget is determined at this time, but revisions, based on the preliminary survey, may be required.
- b. After the preliminary survey.
Correct. The preliminary survey establishes the subject of the review, the theory of the audit approach, and the structure of the project. If the survey discloses significant differences from the project that was placed in the long-range plan, budget adjustments should be requested and authorized.
- c. During the initial planning meeting.
Incorrect. The audit project is not sufficiently well defined at this point to complete the budget.
- d. After the completion of all fieldwork.
Incorrect. At this point, the bulk of the audit hours have been expended and the usefulness of the budget as a control and evaluation tool would be negated.
16. Which of the following activities does **not** constitute audit supervision?
- a. Preparing a preliminary audit program.
Correct. This choice is a planning task.
- b. Providing appropriate instructions to the auditors.
Incorrect. This is a supervisory task.
- c. Reviewing audit working papers.
Incorrect. This is a supervisory task.
- d. Seeing that audit objectives are achieved.
Incorrect. This is a supervisory task.

17. When reviewing audit working papers, the **primary** responsibility of an audit supervisor is to determine that:

- a. Each worksheet is properly identified with a descriptive heading.

Incorrect. While it is true that a descriptive heading generally should be on each worksheet, it is not of primary importance.

- b. Working papers are properly referenced and kept in logical groupings.

Incorrect. While it is desirable that working papers be properly referenced, it is not of primary importance.

- c. Standard departmental procedures are adhered to with regard to working paper preparation and technique.

Incorrect. Although a supervisor would be concerned as to whether departmental procedures are followed, it is not of primary importance.

- d. Working papers adequately support the audit findings, conclusions, and reports.

Correct. IIA *Standards* require that appropriate audit supervision include the determination that working papers adequately support findings, conclusions, and reports. This is of primary importance because nothing reduces the credibility of an internal audit department as much as ineptly developed findings that can collapse under attack.

18. When hiring entry-level internal audit staff, which of the following will **most** likely predict the applicant's success as an auditor?

- a. Grade point average on college accounting courses.

Incorrect. Accounting educational performance is undoubtedly one criterion that must be examined. Reviewing the performance in only one subject area is much too limited a criterion when the broad scope of internal auditing work is considered.

- b. Ability to fit well socially into a group.

Incorrect. The ability to get along well socially is a benefit to any internal auditor but cannot be considered the most important characteristic of a good candidate.

- c. **Ability to organize and express thoughts well.**

No characteristic gets to the heart of an internal auditor's job more than the ability to gather, analyze, and draw conclusions from facts. The internal auditor's success in implementing well-founded recommendations is most closely tied to his or her ability to communicate.

- d. Level of detailed knowledge of the company.

Incorrect. Entry-level internal auditors typically would have relatively little detailed knowledge of the company. It is desirable for applicants to demonstrate a general knowledge of the company, but this is not the most reliable predictor of successful performance as an internal auditor.

19. An internal auditing supervisor, when reviewing a staff member's working papers, identified an unsupported statement that the auditee's unit was operating inefficiently. What action should the supervisor direct the auditor to take?
- a. Remove the comment from the working paper file.
Incorrect. While this might become necessary, if the staff auditor has reason to believe inefficiency, an attempt to support that belief is the first priority.
 - b. Obtain the auditee's concurrence with the statement.
Incorrect. Without support, this statement does not have credibility. It is conjecture and violations of *Standards*.
 - c. **Research and identify criteria to measure operating efficiency.**
Correct. At a minimum, this would be needed to comply with IIA Standards as to having the working papers complete. A standard or norm for efficient operation has to be used to measure how inefficient an operation is before such an opinion can be rendered.
 - d. Explain that it is the opinion of the staff member.
Incorrect. Without support, this statement does not have credibility. It is conjecture and violations of *Standards*.
20. Internal auditors often include summaries within their working papers. Which of the following **best** describes the purpose of such summaries?
- a. Summaries are prepared to conform to IIA *Standards*.
Incorrect. This choice is not required by IIA *Standards*.
 - b. Summaries are usually required for the completion of each section of an audit program.
Incorrect. Audit programs do not usually require it.
 - c. **Summaries distill the most useful information from several working papers into a more usable form.**
Correct. This is the primary reason for such summaries.
 - d. Summaries are used to document the fact that the auditor has considered all relevant evidence.
Incorrect. This choice is too comprehensive.
21. A working paper is complete when it:
- a. Complies with the auditing department's format requirements.
Incorrect. Format requirements are superficial and indicate only that mechanical requirements have been met. They do not relate to content.
 - b. Contains all of the elements of a finding.
Incorrect. A working paper may relate to only a part of the finding—one element or several.
 - c. Is clear, concise, and accurate.
Incorrect. These items are characteristics of the working paper content. The qualities may be present without the working paper being complete.
 - d. **Satisfies the audit objective for which it is developed.**
Correct. This is the objective of each working paper: to support the particular purpose for which the working paper was generated.
22. Working papers have the following characteristic:
- a. They are the property of the organization and are available to all company employees.
Incorrect. While working papers are the property of the organization, they should be made available only to authorized personnel.
 - b. **They document the auditing procedures performed, the information obtained, and the conclusions reached.**
Correct. Working papers do document auditing procedures, information obtained, and the conclusions reached.
 - c. They become the property of the independent outside auditors when completed.
Incorrect. Although it is common practice for internal auditors to grant access to working papers to the independent outside auditors, the internal audit working papers are the property of the organization.
 - d. They should be retained permanently in the organization's records.
Incorrect. Working paper retention should be consistent with the guidelines of the organization and should satisfy pertinent legal or regulatory requirements.

23. Which of the following should be identified as a deficiency by an audit supervisor when reviewing a set of working papers?
- a. A memorandum explaining why the time budget for a part of the audit was exceeded.
Incorrect. This is appropriate to include in working papers.
 - b. **An audit finding recorded in the working papers and report draft that omits the criteria used for evaluation.**
Correct. This would indeed be a deficiency because the basis for comparing what was, with what should have been would be missing.
 - c. A memorandum explaining why an audit program step was omitted.
Incorrect. This is appropriate to include in working papers.
 - d. A letter to the auditee outlining the scope of the audit.
Incorrect. This is appropriate to include in working papers.
24. Which of the following techniques is **best** for emphasizing a point in a written communication?
- a. Place the point in the middle rather than at the beginning or end of the paragraph.
Incorrect. Placing it at the beginning or end of the paragraph best emphasizes the point.
 - b. Use passive rather than active voice.
Incorrect. Use of the active voice best emphasizes the point.
 - c. Highlight the point through the use of nonparallel structure.
Incorrect. Parallel structure will emphasize the point better. Nonparallel structure usually detracts from the point.
 - d. **Use a short sentence with one idea rather than a longer sentence with several ideas.**
Correct. Long sentences with several ideas will create information overload and disguise the important point.
25. Which of the following statements conveys negative information in such a way that a favorable response from the auditee may still be achieved?
- a. Your bookkeeper has failed to reconcile the bank statement each month.
Incorrect. Placing the blame and using words such as "failed" will make the individual react negatively.
 - b. **The bank statements have not been reconciled each month.**
Correct. Using the passive version without placing blame or making the statement personal is more likely to make the reader react positively.
 - c. Unfortunately, your bookkeeper has not taken the time to reconcile the bank statement each month.
Incorrect. Placing the blame in a manner that seems mean-spirited and using words such as "unfortunately" will make the reader react negatively.
 - d. You have apparently failed to inform your bookkeeper that the bank statements should be reconciled on a timely basis.
Incorrect. Placing the blame on the reader and using words such as "failed" will make the reader react negatively.

26. An internal audit director has noticed that staff auditors are presenting more oral reports to supplement written reports. The best reason for the increased use of oral reports by the auditors is that such reports:

- a. Reduce the amount of testing required to support audit findings.

Incorrect. The amount of testing required to support audit findings is unrelated to the use of oral reports. Whether findings are reported through oral or written reports, they still must be adequately supported.

- b. Can be delivered in an informal manner without preparation.

Incorrect. Even though audit reports are delivered orally, they still should be prepared carefully. Poorly planned and delivered oral reports will be difficult for the audience to follow and may create unnecessary misunderstandings.

- c. Can be prepared using a flexible format, thereby increasing overall audit efficiency.

Incorrect. The format of the report will depend on the audience. Factors to consider in delivering reports may include the background and expectations of the audience as well as the time available. This applies to both written and oral reports. Since oral reports do not eliminate the need for a final report, overall audit efficiency is not affected.

- d. Permit auditors to counter arguments and provide additional information that the audience may require.**

Correct. Oral reports permit auditors to counter arguments and provide additional information that the audience may require. Since oral reports evoke face-to-face responses, auditors can provide an immediate response to any auditee objections or provide additional information as appropriate.

27. An internal auditor has completed an audit of an organization's activities and is ready to issue a report. However, the auditee disagrees with the internal auditor's conclusions. The auditor should:

- a. Withhold the issuance of the audit report until agreement on the issues is obtained.

Incorrect. As long as the auditor is satisfied that the audit is completed, it would be inappropriate to delay the issuance of the audit report. Further, agreement may never be obtained.

- b. Perform more work, with the auditee's concurrence, to resolve areas of disagreement. Delay the issuance of the report until agreement is reached.

Incorrect. The auditor is satisfied with the audit conclusions. There would be little justification for expanding the audit work.

- c. Issue the audit report and indicate that the auditee has provided a scope limitation that has led to a difference as to the conclusions.

Incorrect. The disagreement is not caused by a scope limitation.

- d. Issue the audit report and state both the auditor and auditee positions and the reasons for the disagreement.**

Correct. This would be consistent with IIA Standards.

28. According to IIA *Standards*, reported audit findings emerge by a process of comparing what should be with what is. In determining what should be during an audit of a company's treasury function, which of the following would be the **least** desirable criteria against which to judge current operations?
- a. **The operations of the treasury function as documented during the last audit.**
Correct. Past practices may or may not have been at the level of best practices or may not have been in compliance with company procedures. This would not be an appropriate criterion.
- b. Company policies and procedures delegating authority and assigning responsibilities.
Incorrect. Company policies and procedures specify what should be a part of the treasury function's operations.
- c. Finance textbook illustrations of generally accepted good treasury function practices.
Incorrect. Generally accepted good practices can usually be found in leading textbooks describing the field. The auditor should look to the finance discipline for a description of good practices.
- d. Codification of best practices of the treasury function in relevant industries.
Incorrect. Industry identification of best practices can serve as relevant criteria for both the auditor and the organization.
29. Which of the following is **not** a major purpose of an audit report?
- a. Inform.
Incorrect. This is a major purpose.
- b. Get results.
Incorrect. This is a major purpose.
- c. **Assign responsibility.**
Correct. Assigning responsibility is a function of management.
- d. Persuade.
Incorrect. This is a major purpose.
30. Which of the following would **not** be included in the statement of scope in an audit report?
- a. Period covered by the audit.
Incorrect. This should be included in the scope section.
- b. **Audit objectives.**
Correct. This should be included in the purpose section.
- c. Activities not audited.
Incorrect. This should be included in the scope section.
- d. Nature and extent of the auditing performed.
Incorrect. This should be included in the scope section.
31. Providing useful and timely information and promoting improvements in operations are goals of internal auditors. To accomplish this in their reports, auditors should provide:
- a. Top management with reports that emphasize the operational details of defective conditions.
Incorrect. Top management can best perceive general concepts.
- b. Operating management with reports that emphasize general concerns and risks.
Incorrect. Operating management can best perceive details of operations.
- c. Information in written form before it is discussed with the auditee.
Incorrect. Do not surprise auditees; discuss the matters with them before they are reported.
- d. **Reports that meet the expectations and perceptions of both operational and top management.**
Correct. The audit report needs to address the expectations and perceptions both of the top management and the operating management. As a result, it needs general concepts as well as details of operations.

32. Auditors realize that at times corrective action is not taken even when agreed to by the appropriate parties. This should lead an internal auditor to:
- a. **Decide the extent of necessary follow-up work.**
Correct. IIA Standards state that the director of internal auditing should determine the nature, timing, and extent of follow-up.
- b. Allow management to decide when to followup, since it is management's ultimate responsibility.
Incorrect. IIA Standards state that follow-up work is not management's responsibility.
- c. Decide to conduct follow-up work only if management requests the auditor's assistance.
Incorrect. IIA Standards state that follow-up work is not management's responsibility.
- d. Write a follow-up audit report with all findings and their significance to the operations.
Incorrect. The auditor has to provide an opinion as to the decision made with regard to lack of action.
33. Follow-up activity may be required to ensure that corrective action has taken place for certain findings. The internal audit department's responsibility to perform follow-up activities as required should be defined in the:
- a. **Internal auditing department's written charter.**
Correct. Responsibility for follow-up should be defined in the internal auditing department's written charter.
- b. Mission statement of the audit committee.
Incorrect. Follow-up is not specified in the content of the audit committee's mission statement.
- c. Engagement memo issued prior to each audit assignment.
Incorrect. This memo may contain a statement about responsibility for follow-up, but such a statement should be based on the wording and authority of the departmental charter.
- d. Purpose statement within applicable audit reports.
Incorrect. Follow-up authority and responsibility may be cited in applicable audit reports, but first the definition should be contained in the departmental charter.
34. Given the acceptance of the cost savings audits and the scarcity of internal audit resources, the audit manager also decided that follow-up action was not needed. The manager reasoned that cost savings should be sufficient to motivate the auditee to implement the auditor's recommendations. Therefore, follow-up was not scheduled as a regular part of the audit plan. Does the audit manager's decision violate IIA Standards?
- a. No. The Standards do not specify whether follow-up is needed.
Incorrect. Follow-up is required.
- b. Yes. The Standards require the auditors to determine whether the auditee has appropriately implemented all of the auditor's recommendations.
Incorrect. The purpose of follow-up is to see that actions are taken, not just that the auditor's recommendations have been implemented.
- c. **Yes. Scarcity of resources is not a sufficient reason to omit follow-up action.**
Correct. IIA Standards require follow-up action. Lack of resources is not a sufficient reason.
- d. No. When there is evidence of sufficient motivation by the auditee, there is no need for follow-up action.
Incorrect. Follow-up is required.

35. Reporting to senior management and the board is an important part of the auditor's obligation. Which of the following items is **not** required to be reported to senior management and/or the board?

- a. **Subsequent to the completion of an audit, but prior to the issuance of an audit report, the audit senior in charge of the audit was offered a permanent position in the auditee's department.**

Correct. This would not have to be communicated. The audit work was done. The director of internal auditing would have to determine that there was no impairment of the independence of the senior's work. If there was none, the report could be issued without reporting the personnel change.

- b. An annual report summary of the department's audit work schedule and financial budget.

Incorrect. This is a standard part of the required reporting to senior management and the board.

- c. Significant interim changes to the approved audit work schedule and financial budget.

Incorrect. This is a standard part of the required reporting to senior management and the board.

- d. An audit plan was approved by senior management and the board. Subsequent to the approval, senior management informed the audit director not to perform an audit of a division because the division's activities were very sensitive.

Incorrect. Both senior management and the board had approved the audit plan. The change dictated by senior management should be reported to the board.

36. During an audit of purchasing, internal auditors found several violations of company policy concerning competitive bidding. The same condition that had been reported in an audit report last year, and corrective action had not been taken. Which of the following **best** describes the appropriate action concerning this repeat finding?

- a. The audit report should note that this same condition had been reported in the prior audit.

Incorrect. This action is insufficient.

- b. During the exit interview, management should be made aware that a finding from the prior report had not been corrected.

Incorrect. This action is insufficient.

- c. **The director of internal auditing should determine whether management or the board has assumed the risk of not taking corrective action.**

Correct. This action meets the requirements of IIA Standards.

- d. The director of internal auditing should determine whether this condition should be reported to the independent auditor and any regulatory agency.

Incorrect. This action would be inappropriate.

37. Which of the following audit committee activities would be of the **greatest** benefit to the internal auditing department?

- a. Review and approval of audit programs.

Incorrect. Review and approval of audit programs is the responsibility of internal audit supervision.

- b. Assurance that the external auditor will rely on the work of the internal auditing department whenever possible.

Incorrect. External audit's reliance on the work of internal auditing is the subject of an AICPA pronouncement.

- c. Review and endorsement of all internal audit reports prior to their release.

Incorrect. Review and approval of internal audit reports is the responsibility of the director of internal auditing or designee.

- d. **Support for appropriate follow-up of recommendations made by the internal auditing department.**

Correct. The audit committee can lend considerable weight to the recommendations of internal auditing.

38. An internal auditor reported a suspected fraud to the director of internal auditing. The director turned the entire case over to the security department. Security failed to investigate or report the case to management. The perpetrator (employee) continued to defraud the organization until being accidentally discovered by a line manager two years later. Select the **most** appropriate action for the audit director.
- a. The director's actions were correct.
Incorrect. According to the *Standards*, the director should have ensured that the internal auditing department's responsibilities were met with timely follow-up.
- b. **The director should have periodically checked the status of the case with security.**
Correct. The director should have periodically checked the status of the case with security. Follow-up is specified by IIA Standards.
- c. The director should have conducted the investigation.
Incorrect. A security department would generally have more expertise in the investigation of a fraud.
- d. The director should have discharged the perpetrator.
Incorrect. The fraud was only suspected when reported to the director. Immediate discharge would have violated the suspect's rights. In addition, the director would not normally have the authority to discharge an employee in an audited area.
39. If an internal auditor finds that no corrective action has been taken on a prior audit finding that is still valid, IIA *Standards* state that the internal auditor should:
- a. Restate the prior finding along with the findings of the current audit.
Incorrect. By definition, this choice is Incorrect.
- b. **Determine whether management or the board has assumed the risk of not taking corrective action.**
Correct. This is per IIA Standards.
- c. Seek the board's approval to initiate corrective action.
Incorrect. By definition, this choice is Incorrect.
- d. Schedule a future audit of the specific area involved.
Incorrect. By definition, this choice is Incorrect.
40. Internal auditing is responsible for reporting fraud to senior management or the board when:
- a. **The incidence of fraud of a material amount has been established to a reasonable certainty.**
Correct. If the incidence of significant fraud has been established with reasonable certainty, the auditor is responsible for reporting such to senior management or the board.
- b. Suspicious activities have been reported to internal auditing.
Incorrect. No reporting is required when suspicious acts are reported to the auditor.
- c. Irregular transactions have been identified and are under investigation.
Incorrect. Irregular transactions under investigation would not require reporting until the investigation phase is completed.
- d. The review of all suspected fraud-related transactions is complete.
Incorrect. Reporting should occur sooner as per the choice (a).
41. Why should organizations require auditees to promptly reply and outline the corrective action that has been implemented on reported deficiencies?
- a. To close the open audit issues as soon as possible.
Incorrect. This is a mechanical aspect of the audit reporting process.
- b. **To effect savings as early as possible.**
Correct. The objective of the audit is to effect savings resulting from the auditee's corrective action as early as possible so that the organization will benefit from the action taken.
- c. To indicate concurrence with the audit findings.
Incorrect. The auditee may not always concur with the audit findings.
- d. To ensure that the auditor performance is evaluated.
Incorrect. This is an administrative function of the audit department.

Domain 3: Fraud Risks and Controls (5–15%)

1. What is a data diddling technique?

- a. Changing data before input to a computer system.
Incorrect. Although this is one data diddling technique, it is not the most complete answer.
- b. Changing data during input to a computer system.
Incorrect. Although this is one data diddling technique, it is not the most complete answer.
- c. Changing data during output from a computer system.
Incorrect. Although this is one data diddling technique, it is not the most complete answer.
- d. All of the above.

Correct. The data diddling technique involves changing data before or during input to computers or during output from a computer system. Data diddling can be prevented by limiting access to data and programs and limiting the methods used to perform modification to such data and programs. Integrity checking also helps in prevention. Rapid detection is needed—the sooner the better—because correcting data diddling is expensive.

2. What is a salami technique?

- a. Taking small amounts of assets.
Incorrect. Although this is one salami technique, it is not the most complete answer.
- b. Using the rounding-down concept.
Incorrect. Although this is one salami technique, it is not the most complete answer.
- c. Stealing small amounts of money from bank accounts.
Incorrect. Although this is one salami technique, it is not the most complete answer.
- d. All of the above.

Correct. A salami technique is a theft of small amounts of assets and money from a number of sources (e.g., bank accounts, inventory accounts, and accounts payable and receivable accounts). It is also using the rounding-down concept, where a fraction of money is taken from bank accounts.

3. With respect to computer security and fraud, a legal liability exists to an organization under which of the following conditions?

- a. When estimated security costs are greater than estimated losses.
Incorrect. This choice poses no legal liability because costs are greater than losses.
- b. When estimated security costs are equal to estimated losses.
Incorrect. This choice requires judgment and qualitative considerations because costs are equal to losses.

c. When estimated security costs are less than estimated losses.

Correct. Courts do not expect organizations to spend more money than losses resulting from a security flaw, threat, risk, or vulnerability. Implementing countermeasures and safeguards to protect information system assets cost money. Losses can result from risks (i.e., exploitation of vulnerabilities). When estimated costs are less than estimated losses, then a legal liability exists. Courts can argue that the organization's management should have installed safeguards but did not and that management did not exercise due care and due diligence.

- d. When actual security costs are equal to actual losses.
Incorrect. It is not applicable because actual costs and losses are not known at the time of implementing safeguards.

4. Are an investigator's handwritten notes considered valid evidence in court of law?

- a. No.
Incorrect. See correct answer (c)
- b. Maybe.
Incorrect. See correct answer (c)

c. Yes.

Correct. An investigator's handwritten notes are considered valid evidence as long as the affected parties can read and understand the notes. Handwritten notes are no different from typed or printed versions.

- d. Depends.
Incorrect. See correct answer (c)

5. Which of the following security techniques allows time for response by investigative authorities?
- a. Deter.
Incorrect. This choice would not allow such a trap.
 - b. Detect.
Incorrect. This choice would not allow such a trap.
 - c. Delay.
Correct. If a system perpetrator can be delayed longer while attacking a computer system, investigative authorities can trace his or her origins and location.
 - d. Deny.
Incorrect. This choice would not allow such a trap.
6. Most of the evidence submitted in a computer crime case is:
- a. Legal evidence.
Incorrect. "Legal evidence" is a broad term and is not useful here.
 - b. Documentary evidence.
Correct. Documentary evidence is created information, such as letters, contracts, accounting records, invoices, and management information reports on performance and production.
 - c. Secondary evidence.
Incorrect. Secondary evidence is any evidence offered to prove the writing other than the writing itself and is a part of the best evidence rule. The best evidence is original.
 - d. Admissible evidence.
Incorrect. Admissible evidence is evidence that is revealed to the jury or other trier of fact with express or implied permission to use it in deciding disputed issues of fact.
7. When computers and peripheral equipment are seized in relation to a computer crime, it is an example of:
- a. Duplicate evidence.
Incorrect. Duplicate evidence is a document produced by some mechanical process that makes it more reliable evidence of the contents of the original than other forms of secondary evidence (e.g., a photocopy of the original). Modern statutes make duplicates easily substitutable for originals. Duplicate evidence is a part of the best evidence rule.
 - b. Physical evidence.
Correct. Physical evidence is obtained via direct inspection or observation of people, property, or events.
 - c. Best evidence.
Incorrect. Best evidence is evidence that is the most natural and reliable. The best evidence is primary.
 - d. Collateral evidence.
Incorrect. Collateral evidence is evidence relevant only to some evidential fact and that is not by itself relevant to a consequential fact.
8. From a computer security viewpoint, courts expect what amount of care from organizations?
- a. Super care.
Incorrect. See correct answer (b).
 - b. Due care.
Correct. Courts will find computer owners responsible for their insecure systems. Courts will not find liability every time a computer is hijacked. Rather, courts will expect organizations to become reasonably prudent computer owners taking due care (reasonable care) to ensure adequate security. The term "due care" means having the right policies and procedures, access controls, firewalls, and other reasonable security measures in place. Computer owners need not take super care, extraordinary care, or great care, just due care.
 - c. Extraordinary care.
Incorrect. See correct answer (b).
 - d. Great care.
Incorrect. See correct answer (b).

9. Which of the following is **not** a criminal activity in **most** jurisdictions?
- a. **Writing a computer virus program.**
Correct. It is the intentions of the developer of a computer virus program that matter the most in deciding what is a criminal activity. Simply writing a virus program is not a criminal activity.
- b. Using a computer virus program.
Incorrect. Using a virus with intentions of destroying computer resources is a criminal activity.
- c. Releasing a computer virus program.
Incorrect. Releasing a virus with intentions of destroying computer resources is a criminal activity.
- d. Spreading a computer virus program.
Incorrect. Spreading a virus with intentions of destroying computer resources is a criminal activity.
10. Once evidence is seized, a law enforcement officer should follow which of the following?
- a. Chain of logs.
Incorrect. This choice is indirectly related to the chain of custody.
- b. Chain of events.
Incorrect. This choice is indirectly related to the chain of custody.
- c. **Chain of custody.**
Correct. The chain of custody or the chain of evidence is a method of authenticating an object by the testimony of witnesses who can trace possession of the object from hand to hand and from the beginning to the end. It is required when evidence is collected and handled so that there is no dispute about it. It deals with who collected, stored, and controlled the evidence and does not ask who damaged the evidence. It looks at the positive side of the evidence. If the evidence is damaged, there is nothing to show in the court.
- d. Chain of computers.
Incorrect. This choice is indirectly related to the chain of custody.
11. The concept of admissibility of evidence does **not** include which of the following?
- a. Relevance.
Incorrect. Relevant evidence is evidence that had some logical tendency to prove or disprove a disputed consequential fact.
- b. Competence.
Incorrect. Competent evidence (i.e., admissible evidence) is evidence that satisfied all the rules of evidence except those dealing with relevance.
- c. Materiality.
Incorrect. Materiality is the notion that evidence must be relevant to a fact that is in dispute between the parties
- d. **Sufficiency.**
Correct. Laying a proper foundation for evidence is "the practice or requirement of introducing evidence of things necessary to make further evidence relevant, material, or competent." Sufficiency is not part of the concept of admissibility of evidence.
12. Evidence is needed to do which of the following?
- a. Charge a case.
Incorrect. See correct answer (d).
- b. Classify a case.
Incorrect. See correct answer (d).
- c. Make a case.
Incorrect. See correct answer (d).
- d. **Prove a case.**
Correct. Proper elements of proof and correct types of evidence are needed to prove a case. It is proper to maintain computer-related evidence. Special procedures are needed to avoid problems of proof caused by improper care and handling of such evidence.

13. What determines whether a computer crime has been committed?
- a. When the crime is reported.
Incorrect. See correct answer (c).
 - b. When a computer expert has completed his or her work.
Incorrect. See correct answer (c).
 - c. **When the allegation has been substantiated.**
Correct. A computer crime is committed when the allegation is substantiated with proper evidence that is relevant, competent, and material.
 - d. When the investigation is completed.
Incorrect. See correct answer (c).
14. The correct sequence of preliminary investigation is:
- I. Consult with a computer expert.
 - II. Prepare an investigative plan.
 - III. Consult with a prosecutor.
 - IV. Substantiate the allegation.
- a. **IV, I, II, and III.**
Correct. Step 1 is substantiating the allegation. Step 2 is consulting with a computer expert, as appropriate. Step 3 is preparing an investigation plan that sets forth the scope of the investigation and serves as a guide in determining how much technical assistance will be needed. Step 4 is consulting with a prosecutor, depending on the nature of the allegation and scope of the investigation. Items to discuss with the prosecutor may include the elements of proof, evidence required, and parameters of a prospective search.
 - b. III, I, II, and IV.
Incorrect. See correct answer (a).
 - c. IV, II, III, and I.
Incorrect. See correct answer (a).
 - d. I, IV, II, and III.
Incorrect. See correct answer (a).
15. A search warrant is required:
- a. Before the allegation has been substantiated.
Incorrect. See correct answer (b).
 - b. **After establishing the probable cause(s).**
Correct. Once the allegation has been substantiated, the prosecutor should be contacted to determine if there is probable cause for a search. Because of the technical nature of a computer-related crime investigation, presenting a proper technical perspective in establishing probable cause becomes crucial to securing a search warrant.
 - c. Before identifying the number of investigators needed.
Incorrect. See correct answer (b).
 - d. After seizing the computer and related equipment.
Incorrect. See correct answer (b).
16. If a computer or peripheral equipment involved in a computer crime is **not** covered by a search warrant, what should the investigator do?
- a. Seize it before someone takes it away.
Incorrect. See correct answer (b).
 - b. **Leave it alone until a warrant can be obtained.**
Correct. If a computer or peripheral equipment involved in a computer crime is not covered by a search warrant, leave it alone until a warrant can be obtained. The investigator needs a warrant to collect anything.
 - c. Analyze the equipment or its contents, and record it.
Incorrect. See correct answer (b).
 - d. Store it in a locked cabinet in a secure warehouse.
Incorrect. See correct answer (b).
17. Computer fraud is increased when:
- a. Employees are not trained.
Incorrect. There is no direct correlation between computer fraud and this choice.
 - b. Documentation is not available.
Incorrect. There is no direct correlation between computer fraud and this choice.
 - c. **Audit trails are not available.**
Correct. Audit trails indicate what actions are taken by the system. The fact that the system has adequate and clear audit trails will deter fraud perpetrators because they fear getting caught.
 - d. Employee performance appraisals are not given.
Incorrect. There is no direct correlation between computer fraud and this choice.