

Tutorial Letter 202/2/2018

Internal Auditing: Theory & Principles

AUI2601

Semester 2

Department of Auditing

This tutorial letter contains important information about your module.

Bar code

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1 BRIEFING

This tutorial letter contains the solutions to Assignment 02 for this semester. The lecturer has marked a selection of the questions in this assignment. The marks you received for your answers to these questions will constitute your mark for this assignment and will contribute towards your year mark.

You need to assess your answers to the other questions yourself by comparing your answers to those provided in this tutorial letter.

Use the marking plan as a guide to award yourself marks for your answers. Take care not to mark the same concept more than once just because it appears more than once, perhaps in different words or in a different format.

After you have marked your own answers, please reflect carefully on your results to determine why you could not allocate full marks to your answers. Please ensure that you allocate marks only to valid answers. It is imperative that you identify your problem areas now, while you can still do something about them. If you do not solve all your problems as soon as you have identified them, you may repeat the same mistakes in the examination, and that could prove very costly.

Marking your answers should enable you to identify any problems you may be experiencing. Your marks for this assignment will be an indication of your level of knowledge of the module content at this stage. You should still have enough time left to revise the work and solve the identified problem areas before the examination.

We trust that you have found the assignment both interesting and informative and that it has served as an aid for your examination preparation. Should you encounter any difficulties regarding this module in internal auditing, please do not hesitate to contact us.

Lecturer: AUI2601

2 KEY TO ASSIGNMENT 02/2018 (SECOND SEMESTER)

Note the following in the comments below:

The **Standards** refers to the International Standards for the Professional Practice of Internal Auditing

CAE stands for the chief audit executive

IAA stands for the internal audit activity

Question 1**21 marks**

Question	Correct answer	Study guide reference
1.1	1	Learning unit 5
1.2	3	Learning unit 10
1.3	3	Learning unit 5
1.4	4	Learning unit 1
1.5	3	Learning unit 13.4
1.6	1	Learning unit 16
1.7	4	Learning unit 9
1.8	2	Learning unit 12
1.9	4	Learning unit 14
1.10	2	Learning unit 6
1.11	3	Learning unit 6 and 7
1.12	1	Learning unit 6
1.13	1	Learning unit 5
1.14	1	Learning unit 1

Question 2**33 marks****2.1 Core Principles for the Professional Practice of Internal Auditing****Reference:** Learning unit 8

- Demonstrates integrity.
- Demonstrates competence and due professional care.
- Is objective and free from undue influence (independent).
- Aligns with the strategies, objectives, and risks of the organisation.
- Is appropriately positioned and adequately resourced.
- Demonstrates quality and continuous improvement.
- Communicates effectively.
- Provides risk-based assurance.
- Is insightful, proactive and future-focused.
- Promotes organisational improvement

(1 mark each, maximum 6 marks)

2.2 Internal audit terms**Reference:** Learning unit 7

No.	Column A - term	Column B - definition
2.2.1	Chief audit executive	b .A person in a senior position responsible for effectively managing the internal audit activity in accordance with the internal audit charter and the Definition of Internal Auditing, the Code of Ethics, and the Standards. (1)

No.	Column A - term	Column B - definition
2.2.2	Fraud	f. Any illegal act characterised by deceit, concealment or violation of trust. These acts are not dependent upon the threat of violence or physical force. (1)
2.2.3	Risk	i. The possibility of an event occurring that will have an impact on the achievement of objectives. (1)
2.2.4	Assurance services	e. An objective examination of evidence for the purpose of providing an independent assessment on governance, risk management and control processes for the organisation. (1)
2.2.5	Risk appetite	g. The level of risk that an organisation is willing to accept. (1)
2.2.6	Objectivity	c. An unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. (1)
2.2.7	Independence	h. The freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner. (1)

(1 mark each, maximum 7 marks)

2.3 Scenarios permissible or not according to the IIA Code of Ethics

Reference: Learning unit 3.1.2

	Permissible/not permissible (1 mark)	Reference to IIA Code of Ethics (2 marks)	Reasons (1 mark)
2.3.1	Not permissible (1)	Competency (1) Internal auditors should engage only in those services for which they have the necessary knowledge, skills and experience. Or IIA Standards 2340 Engagement Supervision (1) Engagements must be properly supervised to ensure objectives are achieved, quality is assured, and staff is developed. (1)	Simon has no experience to perform the stock take and does not receive adequate supervision. (1)
2.3.2	Not permissible (1)	Integrity (1) Internal auditors shall perform their work with honesty, diligence and responsibility. (Rule of conduct 1.1) (1)	The auditor had no legal or professional obligation to give out that information and therefore did not protect the information

		<p>Or</p> <p>Confidentiality (1) Internal auditors shall be prudent in the use and protection of information acquired in the course of their duties. (Rule of conduct 3.1) (1)</p>	<p>acquired in the course of his duties. (1)</p>
2.3.3	Permissible (1)	<p>IIA Standards 1231 – Use of “Conforms with the International Standards for the Professional Practice of Internal Auditing” The IIA states that it has conducted its activities in accordance with the Standards when it has not been subjected to a quality assurance review. (1) The CAE may state that the IAA conforms to the International Standards for the Professional Practice of Internal Auditing only if the results of the quality assurance and improvement programme support this statement. (1) An external quality review should be performed every five years. (1)</p>	<p>The internal audit activity has adhered to the IIA Standards as they have performed regular internal assessments and an external (independent) assessment has been done three years ago (within a five year period). Therefore it has met the requirements for reporting as such and is allowed to state that it conforms with the International Professional Practice of Internal Auditing (1)</p>
2.3.4	Permissible (1)	<p>IIA Standards 2600 – Resolution of senior management’s acceptance of risks (1) When the CAE believes that senior management have accepted a level of residual risk that may be unacceptable to the organisation he or she must discuss the matter with senior management. If the decision regarding residual risk is not resolved, the CAE must report the matter to the board for resolution. (1)</p> <p>Or</p>	<p>Since the CAE believed that it was a finding that was unacceptable to the organisation and he had also discussed it with senior management with no resolution, he was correct in reporting it to the board (1).</p>

		Objectivity (1) Shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review (1)	
2.3.5	Permissible (1)	IIA Standards 1130 – Impairments to independence and objectivity (1) 1130.A1 – Internal auditors must refrain from assessing specific operations for which they were previously responsible. Objectivity is presumed to be impaired if an internal auditor provides assurance services for an activity for which the internal auditor had responsibility within the previous year. (1)	Since it has been more than a year (18 months) since the internal auditor transferred, he/she is allowed to be involved in the internal audit review. (1)

(Maximum 20 marks)

Question 3**33 marks****3.1 Management and internal audit's responsibilities regarding risk management****Reference:** Learning unit 13. 3

Management is responsible for designing, (½) implementing (½) and monitoring (½) the risk management process and integrating it into the day-to-day activities of the organisation. (1)

The internal audit activity should assist the board, director and management through facilitation and consultation in identifying, (½) evaluating (½) and assessing significant risks (½) and by providing independent assurance (1) as to the adequacy (½) and effectiveness (½) of the related internal controls and the risk management process.

(Maximum 5 marks)

3.2 Difference between external and internal auditing**Reference:** Learning unit 1.5

3.2.1 Certified internal auditor (CIA) (1)

3.2.2 Membership affiliation (1)

3.2.3 Internal audit performs audits throughout the year (1½)

3.2.4 External audit tends to be a year-end process, even though some testing may be carried out during the year. (1½)

3.2.5 Internal audit covers all the organisation's operations. (1½)

3.2.6 Internal audit can be an external contractor **or** an in-house function (1½)

3.2.7 Legally required in the public sector, encouraged in private sector. (1½)

3.2.8 Legally required for all registered companies and the public sector (small companies may have exemptions). (1½)

(Mark as indicated, maximum 11 marks)

3.3 Practices that would enhance a good relationship between the audit committee and the internal audit activity

Reference: Learning unit 16.5

- The chief audit executive should have the following dual-reporting responsibilities:
 - functionally to the audit committee (½), and
 - administratively to the chief executive officer. (½)
- The CAE should have ready access to the audit committee. (1)
- The CAE should have direct and regular communication with the audit committee. (1)
- The CAE should attend audit committee meetings. (1)
- The CAE should meet privately with the audit committee (without management's representatives in attendance) on a regular basis. (1)
- The audit committee should approve the appointment or removal of the CAE. (1)
- The audit committee should be advised by the CAE on his relationship with the external auditors (and on how the internal and external audits are progressing). (1)
- The audit committee should ensure that internal audit function has the necessary resources, budget, standing, authority within the company. (1)

(Maximum 7 marks)

3.4 Elements of internal audit charter

Reference: Learning unit 11.1

The internal audit charter should (a) establish the internal audit activity's position within the organisation; (1) (b) authorise access to records, personnel, and physical properties relevant to the performance of the engagement (1) and define the scope of internal audit activities. (1)

(Maximum 3 marks)

Question 4

20 marks

4.1 Kinds of audit evidence

Reference: Learning unit 14.4

Physical evidence (½) – is obtained by directly observing people, property and events. It can take on the following forms: attendance at a physical stock count and at wage payouts. (1)

Oral evidence (½) – is gathered in the course of interviews or enquiries. Generally, this type of evidence must be supported by documentation or other evidence. (1)

Documentary evidence (½) – Documentary evidence comprises the documents of the auditee which relate to the auditee's business. This type of evidence may be internal or external. External documentary audit evidence originates outside the undertaking and includes letters or memoranda received by the auditee, suppliers' invoices, credit notes received, bank statements and packing sheets. Internal documentary evidence originates within the undertaking and includes sales invoices, paid cheques, credit notes issued and copies of outgoing correspondence. (1)

Evidence generated by the internal auditor (½) – This type of evidence is related to analysis and confirmation. The sources of such evidence are calculations, comparisons with imposed standards, completed operations, similar operations and the combining of information in context. (1)

(Maximum 6 marks)

4.2 Objectives and benefits of audit working papers

Reference: Learning unit 15.4
Practice Advisory 2330-1

Working papers that document the engagement should be prepared by the internal auditor and reviewed by the management of the internal audit activity. (1) The working papers should record the information obtained and the analyses made, and should support the bases for the observations and recommendations to be reported. (1)

Engagement working papers generally:

- Aid in the planning, performance and review of engagements. (1)
- Provide the principal support for the engagement results. (1)
- Document whether the engagement objectives were achieved. (1)
- Support the accuracy and completeness of the work performed. (1)
- Provide a basis for evaluating the internal audit activity's quality assurance and improvement program. (1)
- Facilitate third-party reviews. (1)

(Mark as indicated with a maximum of 8 marks)

4.3 Internal auditor's responsibilities regarding fraud when conducting audit engagements

Reference: Learning unit 12

Standard 1210.A2 – Internal auditors must have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organisation, but are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud. (1)

In conducting audit engagements, the internal auditor should:

- Consider fraud risks in the assessment of internal control design and determination of audit steps to perform. Internal auditors are not expected to detect fraud, but internal auditors are expected to obtain reasonable assurance that business objectives for the process under review are being achieved and material control deficiencies – whether through simple error or intentional effort – are detected. The consideration of fraud risks is documented in the working papers, as well as linkage of fraud risks to specific audit work. (1)
- Have sufficient knowledge of fraud to identify red flags indicating fraud may have been committed. This knowledge includes the characteristics of fraud, the techniques used to commit fraud, and the various fraud schemes and scenarios associated with the activities reviewed. (1)
- Be alert to opportunities that could allow fraud, such as control deficiencies. If significant controls deficiencies are detected, additional tests conducted by internal

- auditors could be used to identify whether fraud has occurred. (1)
- Evaluate whether management is actively retaining responsibility for oversight of the fraud risk management program, that timely and sufficient corrective measures have been taken with respect to any noted control deficiencies or weaknesses, and that the plan for monitoring the program continues to be adequate for the program's ongoing success. (1)
 - Evaluate the indicators of fraud and decide whether any further action is necessary or whether an investigation should be recommended. (1)
 - Recommend investigation when appropriate. (1)

(Maximum 6 marks)

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