

## ADVANCED INTERNAL AUDITING – 2015

### LAST ASSESSMENT OPPORTUNITY NOVEMBER 2015

**FIRST EXAMINERS:** MR W MALHERBE

**SECOND EXAMINER:** PROF B MARX

**EXTERNAL MODERATOR:** ME C TROLLIP

**TIME:** 120 MINUTES


**MARKS:** 100 MARKS

#### INSTRUCTIONS:

1. This paper consists of **twenty two** pages (including the “multiple choice” answer sheet) and **four** appendices. If your paper does not contain all the pages, please put up your hand so that a replacement paper can be handed to you.
2. Answer all the questions.
3. Answer each question on a **separate folio**.
4. Calculate the time that you should spend on each question by multiplying the number of marks for each question by 1,2 to determine the time, in minutes, available for each question. Adhere to these time constraints in order to finish the paper in the given time.
5. Delete **all** (even single open lines) open spaces on your answer sheets with pen. Pages on your answer sheets that contain open spaces will be marked as such and those pages will not be eligible for a remark.
6. No tippex or pencil may be used on your answer sheets. Pages on your answer sheets that contain pencil or tippex will be marked as such and will not be eligible for a remark.
7. All the examination regulations of the UJ and the policy document for students of the Department of Accountancy will apply during this assessment.
8. **You do not have to hand-in this question paper.**
9. The neatness, disclosure and presentation of your answers will be taken into account when marking your paper.
10. Read questions carefully, if you need to provide explanations you should always use full sentences, refrain from simply naming facts.

**QUESTION 1****50 MARKS**

Please indicate the correct answer with an X on the “multiple choice” answer sheet provided. For example:

<b>101</b>	 A	B	C	D
------------	---	---	---	---

1. One of the purposes of the International *Standards* for the Professional Practice of Internal Auditing as stated in the Introduction to the current version of the *Standards* is to
  - a. Encourage the professionalization of internal auditing.
  - b. Establish the independence of the internal audit activity and emphasize the work of internal auditors.
  - c. Encourage external auditors to make more extensive use of the work of internal auditors.
  - d. Establish the basis for evaluating internal auditing performance.
2. Which of the following elements of Action 1 taken by the CAE would be considered inappropriate?
  - I. The type of engagements was changed before modifying the IAA’s charter and going to the audit committee.
  - II. Negative observations were omitted from the engagement communications.
  - III. Cost savings and recommendations were highlighted in the engagement communication.
  - a. I and II.
  - b. I and III.
  - c. I only.
  - d. II and III.
3. The internal audit activity collectively must possess or obtain certain competencies, excluding
  - a. Proficiency in applying internal audit standards.
  - b. An understanding of management principles.
  - c. The ability to maintain good interpersonal relations.
  - d. The ability to conduct training sessions in quantitative methods.

4. The *Standards* require that internal auditors possess which of the following skills?
- I. Internal auditors should understand human relations and be skilled in dealing with people.
  - II. Internal auditors should be able to recognize and evaluate the materiality and significance of deviation from good business practices.
  - III. Internal auditors should be experts on subjects such as economics, commercial law, taxation, finance, and information technology.
  - IV. Internal auditors should be skilled in oral and written communication.
- a. II only
  - b. I and III only.
  - c. III and IV only.
  - d. I, II and IV only.
5. The internal audit activity is considering hiring a person who has a thorough understanding of internal auditing techniques, accounting, and principles of management but has nonspecialized knowledge of economics and information technology. Hiring the person is most appropriate if
- a. A professional development program is agreed to in advance of actual hiring.
  - b. A mentor is assigned to ensure completion of an individually designed professional development program.
  - c. Other internal auditors possess sufficient knowledge of economics and information technology.
  - d. The prospective employee could reasonably be expected to gain sufficient knowledge of these competencies in the long run.

6. Internal auditors are responsible for continuing their education to maintain their proficiency. Which of the following is true regarding the continuing education requirements of the practicing internal auditor?
- a. Internal auditors are required to obtain 40 hours continuing professional education each year and a minimum of 120 hours over a 3-year period.
  - b. CIAs have formal requirements that must be met in order to continue as CIAs.
  - c. Attendance, as an officer or committee member, at formal Institute of Internal Auditors meetings does not meet the criteria of continuing professional development.
  - d. In-house programs meet continuing professional education requirements only if they have been preapproved by The Institute of internal Auditors.
7. During an engagement to evaluate the organisation's accounts payable function, an internal auditor plans to confirm balances with suppliers. What is the source of authority for such contracts with units outside the organisation?
- a. Internal audit policies and procedures
  - b. The *Standards*
  - c. The Code of Ethics
  - d. The internal audit activity's charter
8. To avoid being the apparent cause of conflict between an organization's senior management and the board, the chief audit executive should
- a. Communicate all engagement results to both senior management and the board.
  - b. Strengthen the independence of the internal audit activity through organization position.
  - c. Discuss all reports to senior management with the board first.
  - d. Request board approval of policies that include IAA relationships with the board.

9. An external quality assessment team was evaluating the independence of an internal audit activity. The internal audit activity performs engagements concerning all of the elements included in its scope. Which of the following reporting responsibilities is most likely to threaten their independence? Reporting to the
- a. President
  - b. Treasurer
  - c. Executive vice president
  - d. Audit committee.
10. Internal auditors must be objective in performing their work. Assume that the chief audit executive received an annual bonus as part of that individual's compensation package. The bonus may impair the CAE's objectivity if
- a. The bonus is administered by the board of directors or its salary administration committee.
  - b. The bonus is based on monetary amounts recovered or recommended future savings as a result of engagements.
  - c. The scope of internal auditing is evaluating control rather than account balances.
  - d. Review of a purchasing agent's contract drafts prior to their execution.
11. Objectivity is most likely impaired by an internal auditor's
- a. Continuation on an engagement at a division for which (s)he will soon be responsible as the result of a promotion.
  - b. Reduction of the scope of an engagement due to budget restrictions.
  - c. Participation on a task force that recommends standards for control of a new distribution system.
  - d. Review of a purchase agent's contract drafts prior to their execution.

12. The internal auditors must be able to distinguish carefully between a scope limitation and other limitations. Which of the following is not considered a scope limitation?
- a. The divisional management of an engagement client has indicated that the division is in the process of converting a major computer systems portion of the planned engagement will have to be postponed until next year.
  - b. The board reviews the engagement work schedule for the year and deletes and engagement that the chief audit executive thought was important to conduct.
  - c. The engagement client has indicated that certain customers cannot be contacted because the organization is in the process of negotiating a long-term contract with the customers and they do not want to upset the customers.
  - d. None of the answers are correct.
13. Follow-up activity may be required to ensure that corrective action has taken place for certain observations made in an assurance engagement. The internal audit activities as required should be defined in the
- a. Internal audit activity's charter.
  - b. Mission statement of the audit committee.
  - c. Engagement memo issued prior to each engagement.
  - d. Purpose statement within applicable engagement communications.
14. Which of the following goals sets risk management strategies at the optimum level?
- a. Minimize costs.
  - b. Maximize market share.
  - c. Minimize losses.
  - d. Maximize shareholder value.

15. An internal auditor plans to conduct an audit of the adequacy of controls over investments in new financial instruments. Which of the following would not be required as part of such an engagement?
- a. Determine if policies exist which describe the risks the treasurer may take and the types of instruments in which the treasurer may make investments.
  - b. Determine the extent of management oversight over investments in sophisticated instruments.
  - c. Determine whether the treasurer is getting higher or lower rates of return on investments than are treasurers in comparable organization.
  - d. Determine the nature of controls established by the treasurer to monitor the risks in the investments.
16. Which of the following statements best describes the relationship between planning and controlling?
- a. Planning looks to the future; controlling is concerned with the past.
  - b. Planning and controlling are completely independent of each other.
  - c. Planning present problems; controlling is initiated by problems which have occurred.
  - d. Controlling cannot operate effectively without the tools provided by planning.
17. The internal audit activity of an organization is an integral part of the organization's risk management, control, and governance processes because it evaluates and contributes to the improvement of those processes. Select the type of control provided when the IAA conducts a systems development analysis.
- a. Feedback control.
  - b. Strategic plans.
  - c. Policies and procedures.
  - d. Feedforward control.
18. Which of the following operating controls relate to the organizing function?
- a. Formal procedures for selecting potential suppliers.
  - b. Procedures providing for clear levels of purchase order approvals based on the value of the requisition.
  - c. Written objectives and goals for the department.
  - d. Timely materials reporting to buyers.

19. The chief audit executive (CAE) of a mid-sized internal audit activity (IAA) was concerned that management might outsource the internal auditing function. Thus, the CAE adopted a very aggressive program to promote the IAA within the organization. The CAE planned to present the results to senior management and the board and recommend modification of the IAA's charter after fusing the new program. The following lists six actions the CAE took to promote a positive image within the organization:
1. Engagement assignments concentrated on efficiency. The engagements focused solely on cost savings, and engagement communication highlighted potential costs to be saved. Negative observations were omitted. The focus on efficiency was new, but the engagement clients seemed very happy.
  2. Drafts of all engagement communications were carefully reviewed with the engagement clients to get their input. Their comments were carefully considered when developing the final engagement communication.
  3. The information technology internal auditor participated as part of a development team to review the control procedures to be incorporated into a major computer application under development
  4. Given limited resources, the engagement manager performed a risk assessment to establish engagement work schedule priorities. This was a marked departure from the previous approach of ensuring that all operations are evaluated on at least a 3-year interval.
  5. To save time, the CAE no longer required that a standard internal control questionnaire be completed for each engagement.
  6. When the internal auditors found that the engagement client had not developed specific criteria or data to evaluate operations, the internal auditors were instructed to perform research, develop specific criteria, review the criteria with the engagement client, and, if acceptable, use them to evaluate the engagement client's operations. If the engagement client disagreed with the criteria, a negotiation took place until acceptable criteria could be agreed upon. The engagement communication commented on the engagement client's operations in conjunction with the agreed-upon criteria.



Is Action 5 inappropriate?

- a. Yes. Internal control should be evaluated on every engagement, but the internal control questionnaire is not the mandated approach to evaluate the controls questionnaire is not the mandated approach to evaluate the controls.
  - b. No. Internal auditors may omit necessary procedures if there is a time constraint. It is a matter of professional judgment.
  - c. Yes. Internal control should be evaluated on every engagement, and the internal control questionnaire is the most efficient method to do so.
  - d. No. Internal auditors are not required to fill out internal control questionnaires on every engagement.
20. Which of the following statements is correct regarding corporate compensation systems and related bonuses?
- I. A bonus system should be considered part of the control environment of an organization and should be considered in formulating a report on internal control.
  - II. Compensation systems are not part of an organization's control system and should not be reported as such,
  - III. An audit of an organization's compensation system should be performed independently of an audit of the control system over other functions that impact corporate bonuses.
- a. I only.
  - b. II only.
  - c. III only.
  - d. II and III only.
21. Checks from customers are received in the organization's mail room each day. What controls should be in place to safeguard them?
- a. Establishing a separate post office box for customer payments.
  - b. Forwarding all checks to the cashier upon receipt.
  - c. Requiring a specific mail clerk to list and restrictively endorse each check.
  - d. Providing bonding protection for mail checks.

22. Which of the following observations made during the preliminary survey of a local department store's disbursement cycle reflects a control strength?
- a. Individual department managers use renumbered forms to order merchandise from vendors.
  - b. The receiving department is given a copy of the purchase order complete with a description of goods, quality ordered, and extended price for all merchandise ordered.
  - c. The treasurer's office prepares checks for suppliers based on vouchers prepared by the accounts payable department.
  - d. Individual department managers are responsible for the movement of merchandise from receiving dock to storage or sales areas as appropriate.
23. Which of the following activities represents both an appropriate human resources department function and a deterrent to payroll fraud?
- a. Distribution of paychecks.
  - b. Authorization of overtime.
  - c. Authorization of additions and deletions from the payroll.
  - d. Collection and retention of unclaimed paychecks.
24. Which of the following controls would prevent the ordering of quantities in excess of an organization's needs?
- a. Review of all purchase requisitions by a supervisor in the user department prior to submitting them to the purchasing department.
  - b. Automatic reorder by the purchasing department when low inventory level is indicated by the system.
  - c. A policy requiring review of the purchase order before receiving a new shipment.
  - d. A policy requiring agreement of the receiving report and packing slip before storage of new receipts.

25. One control objective of the financing/treasury cycle is the proper authorization of transactions involving debt and equity instruments. Which of the following controls would best meet this objective?
- a. Separation of responsibility for custody of funds from recording of the transaction.
  - b. Written policies requiring review of major funding/repayment proposals by the board.
  - c. Use of an underwriter in all cases of new issue of debt or equity instruments.
  - d. Requiring two signatures on all checks of a material amount.
26. Which of the following describes a control weakness?
- a. Purchasing procedures are well designed and are followed unless otherwise directed by the purchasing supervisor.
  - b. Pre-numbered blank purchase orders are secured within the purchasing department.
  - c. Normal operational purchases fall in the range from US \$500 to US \$1,000 with two signatures required for purchases over US \$1,000.
  - d. The purchasing agent invests in a publicly traded mutual fund that lists the stock of one of the organization's suppliers in its portfolio.
27. Management can best strengthen internal control over the custody of inventory stored in an off-site warehouse by implementing
- a. Reconciliations of transfer slips to/from the warehouse with inventory records.
  - b. Increases in insurance coverage.
  - c. Regular reconciliation of physical inventories to accounting records.
  - d. Regular confirmation of the amount on hand with the custodian of the warehouse.
28. Which of the following factors is least likely to affect a manager's optimal span of control?
- a. Frequency of supervisor-subordinate contact.
  - b. The managers' willingness to delegate authority.
  - c. The manager's training and communication skills.
  - d. Number of people in the organization.

29. Which organizational structure will likely have unity-of-command problems unless frequent and comprehensive communication occurs among the various functional and project managers?
- a. Line and staff.
  - b. Strategic business unit.
  - c. Centralized.
  - d. Matrix.
30. Which of the following is most likely to be a disadvantage of decentralization
- a. Lower-level employees will develop less rapidly than in a centralized organization.
  - b. Lower-level employees will complain of not having enough to do.
  - c. Top management will have less time available to devote to unique problems.
  - d. Lower-level managers may make conflicting decisions.
31. If a supervisor uses a supportive management approach, evidenced by positive feelings and concern for subordinates, a problem might result because
- a. An approach based on pure power makes it difficult to motivate staff.
  - b. This approach depends on material rewards for the worker
  - c. This approach depends on people who want to work, grow and achieve.
  - d. The manager must believe in the teamwork approach.
32. The manager of a team of actuaries has been asked to develop the basic pricing structure for a new health insurance product. The team has successfully designed other pricing structures in recent years. The manager was assigned to the team 6 months ago. What is the best leadership style for the manager of this team\*
- a. Directive.
  - b. Supportive.
  - c. Participative.
  - d. Achievement-oriented.

33. A chief audit executive plans to make changes that may be perceived negatively by the audit staff. The best way to reduce resistance would be to
- a. Develop the new approach fully before presenting it to the audit staff.
  - b. Ask the chief executive officer (CEO) to approve the changes and have the CEO attend the departmental staff meeting when they are presented.
  - c. Approach the staff with the general idea and involve them in the development of the changes.
  - d. Get the internal audit activity's clients to support the changes.
34. When negotiating with an analytical personality, the negotiator should
- a. Present facts and precedents in an organized manner.
  - b. Push the other party for quick closure of negotiations.
  - c. Focus on creating a bond with the other party.
  - d. Include unimportant items in the proposal for bargaining.
35. During discussions with senior management, the chief audit executive identified several strategic business issues to consider in preparing the annual audit work schedule. Which of the following does not represent a strategic issue for this purpose?
- a. A monthly budgeting process will be implemented.
  - b. An international marketing campaign will be started to develop product recognition and also to leverage the new organization-based advertising department.
  - c. Joint venture candidates will be sought to provide manufacturing and sourcing capabilities in European and Asian markets.
  - d. A human resources database will be established to ensure consistent administration of policies and to improve data retention.
36. Which internal audit planning tool is general in nature and is used to ensure adequate engagement coverage over time?
- a. The audit plan.
  - b. The engagement work program.
  - c. The internal audit activity's budget.
  - d. The internal audit activity's charter.

37. A chief audit executive's performance report should
- List the material engagement observations of major engagements.
  - List uncorrected reported conditions.
  - Report the weekly activities of the individual internal auditors
  - Compare engagements completed with engagements planned.
38. The capabilities of individual staff members are key features in the effectiveness of an internal audit activity. What is the primary consideration used when staffing an internal audit activity?
- Background checks.
  - Job descriptions.
  - Continuing education.
  - Organizational orientation.
39. In most cases, an internal audit activity should document policies and procedures to ensure the consistency and quality of its work. The exception to this principle is directly related to
- Departmentation.
  - Division of labour.
  - Size of the internal audit activity.
  - Authority.
40. The chief audit executive should develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity and continuously monitors its effectiveness. All of the following are included in a quality program except
- Annual appraisals of individual internal auditors' performance.
  - Periodic internal assessment.
  - Supervision.
  - Periodic external assessments.
41. Internal auditors must develop and document a plan for each engagement. The planning process should include all the following except
- Establishing engagement objectives and scope of work.
  - Obtaining background information about the activities to be reviewed.
  - Identifying sufficient information to achieve engagement objectives.
  - Determining how, when, and to whom the engagement results will be communicated.

42. The internal auditors of a financial institution are performing an engagement to evaluate the institution's investing and lending activities. During the last year, the institution has adopted new policies and procedures for monitoring investments and the loan portfolio *the* internal auditors know that the organization has invested in new types of financial instruments during the year and is heavily involved the use of financial derivatives to appropriately hedge risks. If the Internal auditors were to conduct a preliminary review, which of the following procedures should be performed?
- a. Review reports of engagements performed by regulatory and external auditors since the last internal audit engagement.
  - b. Interview management to identify changes made in policies regarding investments or loans.
  - c. Review minutes of board meetings to identify changes in policies affecting investments and loans.
  - d. All of the answers are correct.
43. Assessments of the work of external auditors may be made by the chief audit executive
- a. When the external auditor is appointed.
  - b. When the CAE oversees their work.
  - c. When their work is relied upon by the internal auditors.
  - d. As part of the evaluation of the coordination between the internal and external auditors
44. In the planning phase, the scope of an internal audit engagement is defined by the
- a. Engagement objectives.
  - b. Scheduling and time estimates.
  - c. Preliminary survey.
  - d. Engagement work program.

45. Two major retailers, both publicly traded and operating in the same geographic area, have recently merged. They are approximately the same size and have internal audit activities. Organization A has little EDI experience, Organization B has invested heavily in information technology and has EDI connections with its major vendors. The audit committee has asked the internal auditors from both organizations to analyse risk areas that should be addressed after the merger. The chief audit executive of Organization B has suggested that the two IAA's have a planning meeting to share work programs, scope of coverage, and copies of engagement communications that were delivered to their audit committees. Management has also suggested that the internal auditors review the compatibility of the two computer systems and control philosophy for individual store operations.

One internal auditor has suggested that each IAA conduct an engagement to evaluate consumer satisfaction that would include an analysis of:

- (1) customer complaints recorded by the customer service department during the last 3 months,
- (2) merchandise returned in the last 3 months, and
- (3) responses to a survey of customers who made purchases in the last 3 months.

Which of the following statements regarding this approach is true?

- a. Although useful, such an engagement does not address risk factors and would therefore not be compatible with the audit committee directives.
- b. The survey would not consider customers who did not make purchases in the last 3 months.
- c. Parts 1 and 2 of the engagement plan would not be necessary or cost effective, if a comprehensive customer survey were developed.
- d. None of the answers are correct.

46. An internal auditing team developed a preliminary questionnaire with the following response choices:

- I. Probably not a problem
- II. Possibly a problem
- III. Probably a problem

The questionnaire illustrates the use of:

- a. Trend analysis.
- b. Ratio analysis.
- c. Unobtrusive measures or observations.
- d. Rating scales.



47. The internal auditor found that the purchasing department has a policy of setting all purchasing lead times to the highest number of days experienced within each product subassembly, even though some subassemblies required 3 or more months to complete. To address the objective of reducing inventory holding costs related to this policy, the internal auditor should focus on
- a. Reviewing production requirements for a sample of products to determine at which point in the production process materials and subassemblies are needed.
  - b. Evaluating whether product-line assignments were rotated among the members of the purchasing department.
  - c. Identifying signature approval authority among members of the purchasing department in relation to any computer system controls.
  - d. Testing those products having the highest sales to determine the average number of days that the completed products were held in inventory.
48. Which of the following best describes what determines the extent of supervision required for a particular internal audit engagement?
- a. Whether the engagement involves possible fraud on the part of management.
  - b. Whether the engagement involves possible violations of laws or governmental regulations.
  - c. The proficiency of the internal auditors and the complexity of the engagement.
  - d. The internal audit activity's prior experience in dealing with the particular engagement client.
49. In applying the Rules of Conduct set forth in the IIA Code of Ethics, internal auditors are expected to
- a. Not be unduly influenced by their own interests in forming judgments.
  - b. Compare them with standards of other professions.
  - c. Be guided by the desires of the engagement client.
  - d. Use discretion in deciding whether to use them.

50. A new staff internal auditor was told to perform an engagement in an area with which the internal auditor was not familiar. Because of time constraints, no supervision was provided. The assignment represented a good learning experience, but the area was clearly beyond the internal auditor's competence. Nonetheless, the internal auditor prepared comprehensive working papers and communicated the results to management. In this situation
- a. The internal audit activity violated the *Standards* by hiring an internal auditor without proficiency in the area.
  - b. The internal audit activity violated the *Standards* by not providing adequate supervision.
  - c. The chief audit executive has not violated The IIA Code of Ethics because it does not address supervision.
  - d. The *Standards* and The IIA Code of Ethics were followed by the internal audit activity.

**QUESTION 2****50 MARKS**

The purpose of this question is to assess your understanding of current topics and your ability to contribute to the discussion of these topics. These topics are universal to the internal audit industry and therefore not integrated with a specific scenario or industry.

**PART A****11 MARKS**

Please refer to *Appendix A*.

<b>YOU ARE REQUIRED TO:</b>		
(a)	There are many benefits in the external auditors of a company relying on the internal auditors.  Discuss those <i>International Standards for the Professional Practice of Internal Auditing (IPPF Standards)</i> that will ensure the external auditors can rely on the work done by the internal auditors.	(11)

**PART B****11 MARKS**

Please refer to *Appendix B*.

<b>YOU ARE REQUIRED TO:</b>		
(b)	Discuss the detailed responsibilities of internal audit to manage fraud in an organisation as set by the <i>International Standards for the Professional Practice of Internal Auditing (IPPF Standards)</i> .	(11)

**PART C****11 MARKS**

Please refer to *Appendix C*.

<b>YOU ARE REQUIRED TO:</b>		
(c)	Write an essay on what influenced the evolution of the internal audit industry.	(11)

**PART D****5 MARKS**

Please refer to *Appendix D*.

<b>YOU ARE REQUIRED TO:</b>		
(d)	Write an essay on why it is essential to have good ethics as an internal auditor.	(5)

**PART E****12 MARKS**

The following extract was taken from the July 2012 “Insights on Risk” issued by Ernst & Young. This particular publication was titled: “The future of internal audit is now - Increasing relevance by turning risk into results”.

## Conclusion: adding value

Ernst & Young’s global internal audit survey results confirm that the future of internal audit is now. Nearly three-quarters of respondents believe that internal audit has a positive impact on the organization’s overall risk management efforts. But an even larger majority believes that internal audit can do more – and wants them to do it within the next two years.

**YOU ARE REQUIRED TO:**

(e)	<p><i>It is essential that internal auditors add value to an organisation.</i></p> <p>Write an essay on how an internal audit function can add and protect organisational value.</p>	(12)
-----	--	------

**Student number:**

**QUESTION 1 -**  
**ANSWER SHEET**

Number	Answer
1	
2	
3	
4	
5	
6	
7	
8	
9	
10	
11	
12	
13	
14	
15	

16	
17	
18	
19	
20	
21	
22	
23	
24	
25	
26	
27	
28	
29	
30	
31	
32	
33	

34	
35	
36	
37	
38	
39	
40	
41	
42	
43	
44	
45	
46	
47	
48	
49	
50	