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QUESTION NO: 1

A significant employee fraud took place shortly after an internal audit. The internal auditor may not have properly fulfilled the responsibility for the deterrence of fraud by failing to note and report that

A. Policies, practices, and procedures to monitor activities and safeguard assets were less extensive in low-risk areas than in high-risk areas.

B. A system of control that depended on separation of duties could be circumvented by collusion among three employees.

C. There were no written policies describing prohibited activities and the action required whenever violations are discovered.

D. Divisional employees had not been properly trained to distinguish between bona fide signatures and cleverly forged ones on authorisation forms.

ANSWER: C

QUESTION NO: 2

The internal auditing department has been assigned to perform an audit of a division. Based on background review, the auditor knows the following about management policies:

• Company policy is to rapidly promote divisional managers who show significant success. Thus, successful managers rarely stay at a division for more than three years.

• A significant portion of division management's compensation comes in the form of bonuses based on the division's profitability.

The division was identified by senior management as a turnaround opportunity. The division is growing, but is not scheduled for a full audit by the external auditors this year. The division has been growing about 7% per year for the past three years and uses a standard cost system.

During the preliminary review, the auditor notes the following changes in financial data compared to the prior year:

• Sales have increased by 10%.

• Cost of goods sold has increased by 2%.

• Inventory has increased by 15%.

• Divisional net income has increased by 8%.

It is November and the audit manager is finalising plans for a year-end audit of the division. Based on the above data the audit procedure with highest priority would be to

A. Select sales transactions and trace shipping documents to entries into cost of goods sold to determine if all shipments were recorded.

B. Schedule a complete count of inventory at year-end and have the auditor observe and test the year-end inventory.

C. Schedule a complete investigation of the standard cost system by preparing cost build-ups of a sample of products.

D. Schedule a year-end sales cut-off test.

ANSWER: B

QUESTION NO: 3

The following describes the processes which make up the sales system in operation at Shevhrol and Co.

Which of the following processes represents strength or weakness in the system?

(i) Orders are placed by telephone. When a call is received, the person receiving the order checks that the customer's credit status supports the order and that the customer's current balance is below the maximum level and then immediately inputs the order into the system.

(ii) The order automatically generates a message to the distribution centre which despatches the goods and to the accounts department, which immediately raises an invoice and sends it to the customer.

(iii) Customer queries are dealt with by reception staff.

A. (i) and (ii) represent strengths and (iii) represents weakness

B. (i) represents strength and (ii) and (iii) represent weaknesses

C. (ii) represents strength and (i) and (iii) represent weaknesses

D. All processes represent strengths

ANSWER: B

QUESTION NO: 4

Saturn Ltd has offered Jack Lee to be the head of their treasury department during the audit of Saturn Ltd. Jack Lee is the audit manager who is currently in charge of Saturn Ltd. Jack Lee discussed the role with Saturn Ltd and intends to accept the appointment.

Which of the following is a safeguard that the audit firm of Jack Lee should adopt?

A. Objectivity and independence could be compromised

B. Manager will be carrying out work whilst negotiating position: might overlook errors

C. Possible intimidation of audit team by manager once position taken up

D. Re-review any work of the team previously reviewed by manager/ independent partner review

ANSWER: D

QUESTION NO: 5

Sheraton & Co places orders by telephone. When a call is received, the person receiving the order checks that the customer's credit status supports the order and that the customer's current balance is below the maximum level and then immediately inputs the order into the system.

The risk of management fraud could increase in this case for Sheraton & Co in the presence of _____.

A. improved internal control system of Sheraton & Co

B. frequent changes in supplies by Sheraton & Co

C. substantial increases in sales of Sheraton & Co

D. Sheraton and Co's management incentive system based on sales done in a quarter

ANSWER: D

QUESTION NO: 6

A subsidiary president terminated a controller and hired a replacement without the required corporate approvals. Sales, cash flow, and profit statistics were then manipulated by the new controller and president via accelerated depreciation and sale of capital assets to obtain larger performance bonuses for the controller and the subsidiary president.

Which of the following approaches might detect this fraudulent activity?

A. Analysis of overall management control for segregation of duties.

B. Exit interview for all terminated employees.

C. Periodic changes of outside public accountants.

D. Regular analytical review of operating divisions.

ANSWER: D

QUESTION NO: 7

The internal auditing department has been assigned to perform an audit of a division. Based on background review, the auditor knows the following about management policies:

• Company policy is to rapidly promote divisional managers who show significant success. Thus, successful managers rarely stay at a division for more than three years.

• A significant portion of division management's compensation comes in the form of bonuses based on the division's profitability.

The division was identified by senior management as a turnaround opportunity. The division is growing, but is not scheduled for a full audit by the external auditors this year. The division has been growing about 7% per year for the past three years and uses a standard cost system.

During the preliminary review, the auditor notes the following changes in financial data compared to the prior year:

• Sales have increased by 10%.

• Cost of goods sold has increased by 2%.

• Inventory has increased by 15%.

• Divisional net income has increased by 8%.

If the auditor decides that there are significant problems with the standard cost system, the next audit step to perform would be to

A. Interview divisional management to determine why the standard cost system has not been updated on a timely basis.

B. Select a random sample of products and review the standard cost build-up by tracing purchases to the standard cost record.

C. Use generalised audit software to prepare a listing of gross margin by product by comparing standard cost with sales price. Select all high-gross-margin items for further investigation.

D. Schedule all variances and determine their source and their disposition, that is, whether they are allocated to inventory or cost of goods sold.

ANSWER: D

QUESTION NO: 8

A production manager for a medium-sized manufacturing company began ordering excessive raw materials and had them delivered to a wholesale company he runs as a side business. He falsified receiving documents and approved the invoices for payment.

Which of the following audit procedures would most likely detect this fraud?

A. Take a sample of cash disbursement; compare purchase orders, receiving reports, invoices, and check copies.

B. Take a sample and confirm the amount purchased, purchase price, and date of shipment with the vendors.

C. Observe the receiving dock and count material received; compare your counts to receiving reports completed by receiving personnel.

D. Prepare analytical tests, comparing production, material purchased, and raw material inventory levels and investigate differences.

ANSWER: D

QUESTION NO: 9

Your firm has recently been appointed as auditor to Crate Ltd for the year ending 31 October 2012. This is the first year of audit for Crate Ltd as it fell below the statutory audit exemption limits for the year ended 31 October 2011, which was the company's first period of trading.

Which of the following is NOT a matter to be considered in respect of the opening balances of Crate Ltd?

A. Check opening balances correctly brought forward

B. Check appropriateness of accounting policies or their consistent application from year to year

C. Assess whether financial statements need amendment

D. Ensure disclosure of lack of audit in prior year in financial statements

ANSWER: C

QUESTION NO: 10

A personnel department is responsible for processing placement agency fees for new hires. A recruiter established some bogus placement agencies and, when interviewing walk-in applicants, the recruiter would list one of the bogus agencies as referring the candidate.

A possible means of detection or deterrence is to

A. Process all personnel agency invoices via a purchase order through the purchasing department.

B. Verify new vendors to firms listed in a professional association catalog and/or verify the vendor name and address through the telephone book.

C. Monitor the closeness of the relationships of recruiters with specific vendors.

D. Require all employees to sign an annual conflict of interest statement.

ANSWER: B

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