

Sample Practice Questions, Answers, and Explanations

Domain 1: Mandatory Guidance (35–45%)

1. The IIA's definition of internal auditing emphasizes the effectiveness of which of the following?

a. Value, cost, and benefit propositions.

Incorrect. See correct answer (c).

b. Inherent risk, residual risk, and total risk.

Incorrect. See correct answer (c).

c. Risk management, control, and governance processes.

Correct. The definition of internal auditing states the fundamental purpose, nature, and scope of internal auditing. Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

d. Purpose, nature, and scope of work.

Incorrect. See correct answer (c).

2. Which of the following adds value to the others?

a. Governance processes.

Incorrect. See correct answer (c).

b. Risk management processes.

Incorrect. See correct answer (c).

c. Internal audit activities.

Correct. Internal audit activities add value to the organization (and its stakeholders) when they provide objective and relevant assurance and contribute to the effectiveness and efficiency of governance, risk management, and control processes.

d. Control processes.

Incorrect. See correct answer (c).

3. All of the following are examples of assurance services except:

a. Financial engagement.

Incorrect. Financial engagement is part of assurance services.

b. Compliance engagement.

Incorrect. Compliance engagement is part of assurance services.

c. Due diligence engagement.

Incorrect. Due diligence engagement is part of assurance services.

d. Training engagement.

Correct. Training engagement is a part of consulting. The IIA's Glossary defines assurance services as "objective examination[s] of evidence for the purpose of providing an independent assessment on governance, risk management, and control processes for the organization. Examples may include financial, performance, compliance, system security, and due diligence engagements."

4. All of the following are examples of consulting services **except**:
- a. Legal counsel engagement.
Incorrect. Legal counsel engagement is an example of consulting services.
 - b. System security engagement.
Correct. System security engagement is a part of assurance services. The IIA's Glossary defines consulting services as "[a]dvisory and related client service activities, the nature and scope of which are agreed with the client and are intended to add value and improve an organization's governance, risk management, and control processes without the internal auditor assuming management responsibility. Examples include counsel, advice, facilitation, and training."
 - c. Advice engagement.
Incorrect. Advice engagement is an example of consulting services.
 - d. Facilitation engagement.
Incorrect. Facilitation engagement is an example of consulting services.
5. The IIA's Practice Advisories do **not** contain which of the following?
- a. Approaches.
Incorrect. Approaches are a part of practice advisories.
 - b. Considerations.
Incorrect. Considerations are a part of practice advisories.
 - c. Processes or procedures.
Correct. Processes or procedures are part of Practice Guides, not Practice Advisories. The other three choices are part of practice advisories. Practice Advisories assist internal auditors in applying the definition of internal auditing, the Code of Ethics, and the Standards and promoting good practices. Practice Advisories address internal auditing's approach, methodologies, and consideration but not detailed processes or procedures. They include practices relating to international, country, or industry-specific issues; specific types of engagements; and legal or regulatory issues.
 - d. Methodologies.
Incorrect. Methodologies are a part of practice advisories.
6. The IIA's Practice Guides do **not** contain which of the following?
- a. Good practices.
Correct. Good practices are part of Practice Advisories, not Practice Guides. Practice Guides provide detailed guidance for conducting internal audit activities. Practice Guides include detailed processes and procedures, such as tools and techniques, programs, and step-by-step approaches as well as examples of deliverables.
 - b. Tools and techniques.
Incorrect. Tools and techniques are part of Practice Guides.
 - c. Programs.
Incorrect. Programs are part of Practice Guides.
 - d. Deliverables.
Incorrect. Deliverables are part of Practice Guides.
7. According to the IIA's Organizational Independence *Standard*, which of the following is **not** a part of functional reporting to the board?
- a. Audit charter.
Incorrect. See correct answer (c).
 - b. Audit risk assessment.
Incorrect. See correct answer (c).
 - c. Audit budgets.
Correct. The chief audit executive, reporting functionally to the board and administratively to the organization's chief executive officer, facilitates organizational independence. Functional reporting to the board typically involves the board approving the internal audit activity's overall charter and approving the internal audit risk assessment and related audit plan. Administrative reporting is the reporting relationship within the organization's management structure that facilitates the day-to-day operations of the internal audit activity. Administrative reporting typically includes audit budgets among other things.
 - d. Audit plan.
Incorrect. See correct answer (c).

8. Which of the following differs between assurance services and consulting services when exercising due professional care?
- a. Costs and benefits.
Incorrect. Costs and benefits are the same when exercising due professional care in assurance services and consulting services.
 - b. Complexity of work.
Incorrect. Complexity of work is the same when exercising due professional care in assurance services and consulting services.
 - c. Extent of work.
Incorrect. Extent of work is the same when exercising due professional care in assurance services and consulting services.
 - d. **Materiality.**
Correct. Materiality is considered in assurance services and procedures but is not relevant to consulting services.
9. Which of the following is driving the need for assurance maps?
- a. Risk managers.
Incorrect. Risk managers do not deal with assurance maps.
 - b. **Board members.**
Correct. The chief audit executive, senior management, and the board need assurance maps to ensure proper coordination among diverse risk activities. Assurance maps are usually driven by the board due to its oversight responsibility. Assurance maps are organization-wide and coordinated exercises involving mapping assurance coverage provided by multiple parties against the key risks facing the organization so that duplicate efforts, missed risks, and potential gaps can be identified and monitored.
 - c. Internal auditors.
Incorrect. Internal auditors do not deal with assurance maps.
 - d. Compliance practitioners.
Incorrect. Compliance practitioners do not deal with assurance maps.
10. Risk registers describe direct links between which of the following?
- a. Risk acceptance and risk avoidance.
Incorrect. Risk acceptance and risk avoidance are not related to risk registers.
 - b. **Risk categories and risk aspects.**
Correct. Risk registers provide direct links among risk categories, risk aspects, audit universe, and internal controls.
 - c. Risk assignment and risk sharing.
Incorrect. Risk assignment and risk sharing are not related to risk registers.
 - d. Risk limitation and risk spreading.
Incorrect. Risk limitation and risk spreading are not related to risk registers.
11. The chief audit executive establishes a method for prioritizing all of the following **except**:
- a. Business units with low risk levels.
Incorrect. See correct answer (d).
 - b. Branch or field office with low risk levels.
Incorrect. See correct answer (d).
 - c. Outstanding risk areas.
Incorrect. See correct answer (d).
 - d. **Low inherent risk areas.**
Correct. Audits of lower risk level business units, branch types, or field office types need to be periodically included in the internal audit activity's plan to give them coverage and confirm that their risks have not changed. Also, the internal audit activity establishes a method for prioritizing outstanding risks not yet subject to an internal audit. High inherent risk areas, not low inherent risk areas, are prioritized.

12. All of the following provide effective relationships in the organization's governance framework **except**:
- a. **Organizational processes.**
Correct. Governance does not exist as a set of distinct and separate organizational processes and structures. Rather, there are effective relationships among governance, risk management, and internal controls.
- b. Governance.
Incorrect. Governance provides effective relationships in the organization's governance framework.
- c. Risk management.
Incorrect. Risk management provides effective relationships in the organization's governance framework.
- d. Internal controls.
Incorrect. Internal controls provide effective relationships in the organization's governance framework.
13. Which of the following internal audit assessments belong to specific governance processes?
- a. **Whistleblower process.**
Correct. Internal audit assessments regarding governance processes are likely to be based on information obtained from numerous audit assignments over time. The internal auditor should consider: (1) the results of audits of specific governance processes (e.g., the whistleblower process, the strategy management process) and (2) governance issues arising from audits that are not specifically focused on governance (e.g., audits of the risk management process, internal control over financial reporting, and fraud risks).
- b. Risk management audit process.
Incorrect. See correct answer (a).
- c. Internal control over financial reporting.
Incorrect. See correct answer (a).
- d. Fraud risks.
Incorrect. See correct answer (a).
14. Ensuring internal audit teams have the right competencies with right level of work experience and designing effective internal audit procedures can reduce the risk of which of the following?
- a. Business risk.
Incorrect. Business risk is not applicable here.
- b. **Audit failures.**
Correct. Audit failures result when there is a (1) failure to evaluate both the design adequacy and the control effectiveness as part of internal audit procedures and (2) use of audit teams that do not have the appropriate level of competence based on experience or knowledge of high-risk areas.
- c. Audit false assurance.
Incorrect. Audit false assurance is not applicable here.
- d. Audit reputation risk.
Incorrect. Audit reputation risk is not applicable here.
15. Consulting engagement objectives must be consistent with all of the following **except**:
- a. **Organization's goals.**
Correct. Goals are short term in nature while objectives are long term in nature. Hence, consulting engagement objectives must be consistent with the organization's values, strategies, and objectives.
- b. Organization's values.
Incorrect. See correct answer (a).
- c. Organization's strategies.
Incorrect. See correct answer (a).
- d. Organization's objectives.
Incorrect. See correct answer (a).

16. Which of the following is the **major** purpose of performing analytical procedures in internal audits?
- To perform additional audit procedures.
Incorrect. Performing additional audit procedures is part of obtaining audit evidence.
 - To plan the audit engagement.
Incorrect. Planning the audit engagement is part of obtaining audit evidence.
 - To obtain audit evidence.**
Correct. Analytical procedures often provide the internal auditor with an efficient and effective means of obtaining audit evidence. The assessment results from comparing information with expectations identified or developed by the internal auditor.
 - To study relationships among elements of information.
Incorrect. Studying relationships among elements of information is part of obtaining audit evidence.
17. According to the IIA *Standards*, which of the following is **not** included in the scope of the internal audit function?
- Appraising the effectiveness and efficiency of operations and programs.
Incorrect. Appraising the effectiveness and efficiency of operations and programs is included in the scope of internal auditing as stated in the IIA *Standards*.
 - Reviewing the strategic management process, assessing the quality of management decision making both quantitatively and qualitatively and reporting the results to the audit committee.**
Correct. The scope of the internal audit function does not include an assessment of the company's strategic management process.
 - Reviewing the means of safeguarding assets.
Incorrect. Reviewing the means of safeguarding assets is included in the scope of internal auditing as stated in the IIA *Standards*.
 - Complying with the laws, regulations, policies, procedures, and contracts.
Incorrect. Complying with the laws, regulations, policies, procedures, and contracts is included in the scope of internal auditing as stated in the IIA *Standards*.
18. An internal auditor is auditing the financial operations of an organization. Which of the following is **not** specified by the IIA *Standards* for inclusion in the scope of the audit?
- Reviewing the reliability and integrity of financial and operational information.
Incorrect. Reviewing the reliability and integrity of financial and operational information is the basic element of the audit.
 - Reviewing the compliance with laws, regulations, policies, procedures, and contracts.
Incorrect. The *Standards* include compliance, and there are compliance aspects in financial operations.
 - Appraising the effectiveness and efficiency of operations and programs.
Incorrect. The auditor would review the economy, efficiency, and effectiveness of the financial functions.
 - Reviewing the financial decision-making process.**
Correct. This element of the audit is not included in IIA Standard 2130— Control.
19. The audit committee of an organization has charged the chief audit executive (CAE) with bringing the department into full compliance with the IIA *Standards*. The CAE's first task is to develop a charter. Identify the item that should be included in the statement of objectives:
- Report all audit findings to the audit committee every quarter.
Incorrect. Only significant audit findings should be discussed with the audit committee.
 - Notify governmental regulatory agencies of unethical business practices by organization management.
Incorrect. Internal auditors are not required to report deficiencies in regulatory compliance to the appropriate agencies. However, Institute members and Certified Internal Auditors may not knowingly be involved in illegal acts.
 - Determine the adequacy and effectiveness of the organization's systems of internal controls.**
Correct. This is a primary function of any internal auditing department.
 - Submit departmental budget variance reports to management every month.
Incorrect. This choice is not a primary objective of the internal auditing department. It is a budgetary control that management may require on a periodic basis.

20. If an auditee's operating standards are vague and thus subject to interpretation, the auditor should:

- a. **Seek agreement with the auditee as to the standards to be used to measure operating performance.**

Correct. This is what is required by IIA Standard 2210—Engagement Objectives.

- b. Determine best practices in this area and use them as the standard.

Incorrect. The auditor should seek to understand the operating standards as they are applied to the organization.

- c. Interpret the standards in their strictest sense because standards are otherwise only minimum measures of acceptance.

Incorrect. Agreement is necessary.

- d. Omit any comments on standards and the auditee's performance in relationship to those standards, because such an analysis would be meaningless.

Incorrect. The auditor should first seek to gain an understanding with the auditee on the appropriate standards.

21. In which of the following situations does the auditor potentially lack objectivity?

- a. An auditor reviews the procedures for a new electronic data interchange connection to a major customer before it is implemented.

Incorrect. IIA *Standards* says that the internal auditor's objectivity is not adversely affected when the auditor reviews procedures before they are implemented.

- b. **A former purchasing assistant performs a review of internal controls over purchasing four months after being transferred to the internal auditing department.**

Correct. IIA Standard 1130—Impairment to Independence or Objectivity says that persons transferred to the internal auditing department should not be assigned to audit those activities they previously performed until a reasonable period of time has elapsed.

- c. An auditor recommends standards of control and performance measures for a contract with a service organization for the processing of payroll and employee benefits.

Incorrect. IIA *Standards* say that the internal auditor's objectivity is not adversely affected when the auditor recommends standards of control for systems before they are implemented.

- d. A payroll accounting employee assists an auditor in verifying the physical inventory of small motors.

Incorrect. Use of staff from other areas to assist the internal auditor does not impair objectivity, especially when the staff is from outside of the area being audited.

22. Which of the following actions would be a violation of auditor independence?

- a. **Continuing on an audit assignment at a division for which the auditor will soon be responsible as the result of a promotion.**

Correct. IIA Standard 1130—Impairment to Independence or Objectivity specifies that an auditor who has been promoted to an operating department should not continue on an audit of the new department.

- b. Reducing the scope of an audit due to budget restrictions.

Incorrect. *IIA Standard 1130—Impairment to Independence or Objectivity* states that budget restrictions do not constitute a violation of an auditor's independence.

- c. Participating on a task force which recommends standards for control of a new distribution system.

Incorrect. *IIA Standard 1130—Impairment to Independence or Objectivity* states that an auditor may participate on a task force that recommends new systems. However, designing, installing, or operating such systems might impair objectivity.

- d. Reviewing a purchasing agent's contract drafts prior to their execution.

Incorrect. *IIA Standard 1130—Impairment to Independence or Objectivity* states that an auditor may review contracts prior to their execution.

23. The IIA's Code of Ethics includes which of the following two essential components?

- a. Definition of internal auditing and administrative directives.

Incorrect. See correct answer (b).

- b. **Principles and Rules of Conduct.**

Correct. The IIA's Code of Ethics extends beyond the definition of internal auditing to include two essential components:

1. **Principles that are relevant to the profession and practice of internal auditing.**
2. **Rules of Conduct that describe behavior norms expected of internal auditors. These rules are an aid to interpreting the Principles into practical applications and are intended to guide the ethical conduct of internal auditors.**

Note that the IIA's Bylaws and Administrative Directives are applicable to IIA members and Certified Internal Auditor designation holders. Integrity, objectivity, confidentiality, and competency are part of the Principles and the Rules of Conduct.

- c. Integrity and objectivity.

Incorrect. See correct answer (b).

- d. Confidentiality and competency.

Incorrect. See correct answer (b).

24. A Certified Internal Auditor (CIA) is working in a non-internal audit position as the director of purchasing. The CIA signs a contract to procure a large order from the supplier with the best price, quality, and performance. Shortly after signing the contract, the supplier presents the CIA with a gift of significant monetary value. Which of the following statements regarding the acceptance of the gift is correct?

- a. Acceptance of the gift would be prohibited only if it were noncustomary.

Incorrect. Acceptance of the gift could easily be presumed to have impaired independence and thus would not be acceptable.

- b. Acceptance of the gift would violate the IIA Code of Ethics and would be prohibited for a CIA.**

Correct. As long as an individual is a CIA, he or she should be guided by the profession's Code of Ethics in addition to the organization's code of conduct. Objectivity (Rules of Conduct) of the Code of Ethics would preclude such a gift because it could be presumed to have influenced the individual's decision.

- c. Since the CIA is no longer acting as an internal auditor, acceptance of the gift would be governed only by the organization's code of conduct.

Incorrect. There is not sufficient information given to judge possible violations of the organization's code of conduct. However, the action could easily be perceived as a kickback.

- d. Since the contract was signed before the gift was offered, acceptance of the gift would not violate either the IIA Code of Ethics or the organization's code of conduct.

Incorrect. There is not sufficient information given to judge possible violations of the organization's code of conduct. However, the action could easily be perceived as a kickback.

25. An auditor, nearly finished with an audit, discovers that the director of marketing has a gambling habit. The gambling issue is not directly related to the existing audit, and there is pressure to complete the current audit. The auditor notes the problem and passes the information on to the chief audit executive but does no further follow-up. The auditor's actions would:

- a. Be in violation of the IIA Code of Ethics for withholding meaningful information.

Incorrect. The auditor is not withholding information because he or she has passed the information along to the chief audit executive. The information may be useful in a subsequent audit in the marketing area.

- b. Be in violation of the *Standards* because the auditor did not properly follow-up on a red flag that might indicate the existence of fraud.

Incorrect. The auditor has documented a red flag that may be important in a subsequent audit. This does not violate the *Standards*.

- c. Not be in violation of either the IIA Code of Ethics or the *Standards*.**

Correct. There is no violation of either the Code of Ethics or the *Standards*.

- d. Both a and b.

Incorrect. See correct answer (c).

26. As used by the internal auditing profession, the IIA *Standards* refer to all of the following **except**:

- a. Criteria by which the operations of an internal audit department are evaluated and measured.

Incorrect. This is the definition of the IIA *Standards*.

- b. Criteria which dictate the minimum level of ethical actions to be taken by internal auditors.**

Correct. The IIA's Code of Ethics defines the minimum ethical standards for the internal auditor.

- c. Statements intended to represent the practice of internal auditing, as it should be.

Incorrect. The *Standards* define the practice of internal auditing "as it should be."

- d. Criteria that is applicable to all types of internal audit departments.

Incorrect. The IIA *Standards* are equally applicable across all industries and all types of internal audit organizations globally.

27. Which of the following situations would be a violation of the IIA Code of Ethics?

- a. An auditor was subpoenaed in a court case in which a merger partner claimed to have been defrauded by the auditor's company. The auditor divulged confidential audit information to the court.

Incorrect. Article II prohibits members and Certified Internal Auditors from being party to illegal activities. Failure to comply with a subpoena would be illegal.

- b. An auditor for a manufacturer of office products recently completed an audit of the corporate marketing function. Based on this experience, the auditor spent several hours one Saturday working as a paid consultant to a hospital in the local area, which intended to conduct an audit of its marketing function.

Incorrect. A part-time job would not be a problem since it was not with a competitor or supplier.

- c. An auditor gave a speech at a local IIA chapter meeting outlining the contents of a program the auditor had developed for auditing electronic data interchange connections. Several auditors from major competitors were in the audience.

Incorrect. Giving a speech is not a violation of the Code of Ethics. In fact, the IIA's motto is "progress through sharing."

- d. **During an audit, an auditor learned that the company was about to introduce a new product that would revolutionize the industry. Because of the probable success of the new product, the product manager suggested that the auditor buy additional stock in the company, which the auditor did.**

Correct. Confidentiality (Rules of Conduct) of the IIA's Code of Ethics states that members and Certified Internal Auditors shall not use confidential information for any personal gain.

28. In applying the standards of conduct set forth in the Code of Ethics, internal auditors are expected to:

- a. **Exercise their individual judgment.**

Correct. The IIA's Code of Ethics contains basic principles, such as integrity, which require individual judgment to apply.

- b. Compare them to standards in other professions.

Incorrect. While the comparison might be interesting, it would not help determine how to apply the Code.

- c. Be guided by the desires of the auditee.

Incorrect. Application might not be in the best interest of the auditee.

- d. Use discretion in deciding whether to use them or not.

Incorrect. Judgment may be applied to their use but not to whether to use them of their involvement, as well as future objectivity and independence issues.

29. Reinforcing the Code of Conduct and ethical behavior standards for all internal auditors can protect which of the following?

- a. Business risk.

Incorrect. See correct answer (d).

- b. Audit failures.

Incorrect. See correct answer (d).

- c. Audit false assurance.

Incorrect. See correct answer (d).

- d. **Audit reputation risk.**

Correct. A leading practice to protect the reputation of internal audit's "brand" name is to reinforce the Code of Conduct and ethical behavior standards for all internal auditors.

Domain 2: Internal Control and Risk (25–35%)

1. An exception report for management is an example of which of the following?
 - a. Preventive control.
Incorrect. See correct answer (c).
 - b. Detective control.
Incorrect. See correct answer (c).
 - c. **Corrective control.**
Correct. Detecting an exception in a business transaction or process is detective in nature, but reporting it is an example of a corrective control. Both preventive and directive controls do not detect or correct an error; they simply stop the error, if possible.
 - d. Directive control.
Incorrect. See correct answer (c).
2. Organizational procedures allow employees to anticipate problems. This type of control is known as:
 - a. Feedback control.
Incorrect. This is a retrospective control based on the outcome of a completed activity.
 - b. Strategic control.
Incorrect. This is a broader-based control that should go hand in hand with strategic planning.
 - c. **Feed-forward control.**
Correct. Procedures provide guidance on how tasks should be accomplished.
 - d. Performance appraisal.
Incorrect. This is a retrospective control.
3. As part of a total quality control program, a firm not only inspects finished goods but also monitors product returns and customer complaints. Which type of control best describes these efforts?
 - a. **Feedback control.**
Correct. Feedback control ensures that past mistakes are not repeated.
 - b. Feed-forward control.
Incorrect. The controls mentioned occur after processing and therefore cannot provide feed-forward control.
 - c. Production control.
Incorrect. Complaints are not part of production control.
 - d. Inventory control.
Incorrect. The question is not limited to inventory.
4. To be successful, large companies must develop means to keep the organization focused in the proper direction. Organization control systems help keep companies focused. These control systems consist of which of the following components?
 - a. Budgeting, financial ratio analysis, and cash management.
Incorrect. These are means of financial control.
 - b. **Objectives, standards, and an evaluation-reward system.**
Correct. These items are the basic components of complex organizational control systems in large companies.
 - c. Role analysis, team building, and survey feedback.
Incorrect. These are several types of organizational development interventions.
 - d. Coaching, protection, and challenging assignments.
Incorrect. Mentoring fulfills several types of career enhancement functions, including these.
5. **Control** has been described as a closed system consisting of six elements. Identify one of the six elements.
 - a. **Setting performance standards.**
Correct. Setting performance standards is one of the six elements.
 - b. Adequately securing data files.
Incorrect. This choice is not an element of a closed control system.
 - c. Approval of audit charter.
Incorrect. This choice is not an element of a closed control system.
 - d. Establishment of independent audit function.
Incorrect. This choice is not an element of a closed control system.

6. The three basic components of all organizational control systems are:
- a. **Objectives, standards, and an evaluation-reward system.**
Correct. These are the three basic components of a control system.
- b. Plans, budgets, and organizational policies and procedures.
Incorrect. These three terms are all used to describe subsystems of a control system.
- c. Statistical reports, audits, and financial controls.
Incorrect. These three terms are used to describe either a subsystem of a control process or a tool used in a control system.
- d. Inputs, objectives, and an appraisal system.
Incorrect. While "objectives" is a correct answer, the other two terms are incorrect. "Inputs" is a good distracter because it is part of the "input-process-output" relationship used to describe a system.
7. Which of the following management control systems measures performance in terms of operating profits minus the cost of capital invested in tangible assets?
- a. Open-book management system.
Incorrect. The open-book management system focuses on sharing company's financial information to all employees.
- b. **Economic value added system.**
Correct. The economic value added system is a new system to measure corporate performance.
- c. Activity-based costing system.
Incorrect. The activity-based costing system identifies various activities needed to produce a product or service and determines the cost of those activities.
- d. Market value added system.
Incorrect. The market value added system determines the market value of a firm based on its market capitalization rate.
8. A comprehensive management control system that considers both financial and nonfinancial measures relating to a company's critical success factors is called a(n):
- a. **Balanced scorecard system.**
Correct. The balanced scorecard system is a comprehensive management control system that balances the traditional accounting (financial) measures with the operational (nonfinancial) measures.
- b. Economic value added system.
Incorrect. See correct answer (a).
- c. Activity-based costing system.
Incorrect. See correct answer (a).
- d. Market value added system.
Incorrect. See correct answer (a).
9. According to the IIA Planning *Standard*, the term "risk appetite" means which of the following?
- a. Risk avoidance.
Incorrect. Risk avoidance is eliminating the risk cause and/or consequence.
- b. Risk limitation.
Incorrect. Risk limitation implements controls to minimize the adverse impact of a threat.
- c. **Risk acceptance.**
Correct. Risk acceptance is the level of risk that an organization is willing to accept, and it is referred to as risk appetite.
- d. Risk spreading.
Incorrect. Risk spreading is sharing the risk with other divisions or business units of the same organization.

10. According to the IIA Planning *Standard*, residual risk is also known as which of the following?
- Audit risk.
Incorrect. Audit risk results when an auditor fails to detect a material error or event, and an auditor may fail to detect significant error or weakness during an examination.
 - Pure risk.
Incorrect. Pure risks are those in which there is a chance of loss or no loss only.
 - Current risk.**
Correct. Residual risk is current risk, which is the risk remaining after management takes action to reduce the impact and likelihood of an adverse event, including control activities in responding to a risk. Current risk is often defined as the risk managed within existing controls or control systems. Current risk cannot be ignored; instead, it should be managed well so it can become a managed risk.
 - Inherent risk.
Incorrect. Inherent risk is a built-in risk; an example is the susceptibility of information or data to a material misstatement.
11. Residual risk is calculated as which of the following?
- Known risks minus unknown risks.
Incorrect. See correct answer (d).
 - Actual risks minus probable risks.
Incorrect. See correct answer (d).
 - Probable risks minus possible risks.
Incorrect. See correct answer (d).
 - Potential risks minus covered risks.**
Correct. Potential risks include all possible and probable risks. Countermeasures cover some but not all risks. Therefore, the residual risk is potential risks minus covered risks.
12. Which of the following is closely linked to risk acceptance?
- Risk detection.
Incorrect. See correct answer (c).
 - Risk prevention.
Incorrect. See correct answer (c).
 - Risk tolerance.**
Correct. Risk tolerance is the level of risk that an entity or a manager is willing to assume or accept in order to achieve a potential desired result. Some managers accept more risk than others do due to their personal affinity to risk.
 - Risk correction.
Incorrect. See correct answer (c).
13. Which of the following risk concepts can be assumed to have **no** mitigating controls?
- Business risk.
Incorrect. Business risk is total risk facing an organization.
 - Residual risk.
Incorrect. Residual risk is current risk.
 - Inherent risk.**
Correct. Two fundamental risk concepts are inherent risk and residual risk (also known as current risk). Inherent risk is a built-in risk. To financial/external auditors, inherent risk can be summarized as the susceptibility of information or data to a material misstatement, assuming that there are no related mitigating controls.
 - Current risk.
Incorrect. Inherent risk is the susceptibility of a management assertion to a material misstatement.

14. The internal audit charter normally requires the internal audit activity to focus on areas consisting of which of the following?
- a. **High inherent risk and high residual risk.**
Correct. The internal audit charter normally requires the internal audit activity to focus on areas of high risk, including both inherent and residual risk. The internal audit activity needs to identify areas of high inherent risk, high residual risks, and the key control systems upon which the organization is most reliant.
- b. High audit risk and high current risk.
Incorrect. See correct answer (a).
- c. Low inherent risk and low audit risk.
Incorrect. See correct answer (a).
- d. Low inherent risk and high outstanding risk.
Incorrect. See correct answer (a).
15. Internal auditors would be more likely to detect fraud if they developed/strengthened their ability to:
- a. **Recognize and question changes which occur in organizations.**
Correct. The recognition and questioning of change is critical to the detection of fraud.
- b. Interrogate fraud perpetrators to discover why the fraud was committed.
Incorrect. Interrogation of fraud perpetrators occurs after detection.
- c. Develop internal controls to prevent the occurrence of fraud.
Incorrect. The controls mentioned are preventive, not detective.
- d. Document computerized operating system programs.
Incorrect. Documentation of operating systems is not within the scope of internal auditing and would do little to enhance fraud detection skills.
16. According to the IIA *Standards*, which of the following **best** describes the two general categories or types of fraud that concern most internal auditors?
- a. Improper payments (i.e., bribes and kickbacks) and tax fraud.
Incorrect. These are examples of kinds of fraud within the two general categories or types given in the *Standards*.
- b. **Fraud designed to benefit the organization and fraud perpetrated to the detriment of the organization.**
Correct. These are the two overall categories or types of fraud given in the IIA *Standards*.
- c. Acceptance of bribes or kickbacks and improper related-party transactions.
Incorrect. These are examples of kinds of fraud within the two general categories or types given in the *Standards*.
- d. Acceptance of kickbacks or embezzlement and misappropriation of assets.
Incorrect. These are examples of kinds of fraud within the two general categories or types given in the *Standards*.
17. A company hired a highly qualified accounts payable manager who had been terminated from another company for alleged wrongdoing. Six months later, the manager diverted \$12,000 by sending duplicate payments of invoices to a relative. A control that might have prevented this situation would be to:
- a. **Adequately check prior employment backgrounds for all new employees.**
Correct. This practice might give some leads to previous shortcomings.
- b. Not hire individuals who appear overqualified for a job.
Incorrect. Individuals in their declining years may be forced to accept jobs below their full capabilities.
- c. Verify educational background for all new employees.
Incorrect. This does not include checking prior employment.
- d. Check to see if close relatives work for vendors.
Incorrect. This is not an adequate control in this scenario.

18. Red flags are conditions that indicate a higher likelihood of fraud. Which of the following would **not** be considered a red flag?

- a. Management has delegated the authority to make purchases under a certain dollar limit to subordinates.

Correct. This is an acceptable control procedure aimed at limiting risk while promoting efficiency. It is not, by itself, considered a red flag.

- b. An individual has held the same cash-handling job for an extended period without any rotation of duties.

Incorrect. Lack of rotation of duties or cross-training for sensitive jobs is one of the red-flag list factors.

- c. An individual handling marketable securities is responsible for making the purchases, recording the purchases, and reporting any discrepancies and gains/losses to senior management.

Incorrect. This would be an example of an inappropriate segregation of duties, which is an identified red flag.

- d. The assignment of responsibility and accountability in the accounts receivable department is not clear.

Incorrect. This is an identified red flag.

19. Internal auditors and management have become increasingly concerned about computer fraud. Which of the following control procedures would be **least** important in preventing computer fraud?

- a. Program change control that requires a distinction between production programs and test programs.

Incorrect. This is one of the elements of good program change control.

- b. Testing of new applications by users during the systems development process.

Incorrect. Testing of new applications by users is one of the most important controls to help prevent computer fraud.

- c. Segregation of duties between the applications programmer and the program librarian function.

Incorrect. An adequate control structure over program changes is one of the most important control procedures in a computerized environment.

- d. Segregation of duties between the programmer and systems analyst.

Correct. This would be the least important control procedure. The analyst is responsible for communicating the nature of the design to the programmer. There is no control reason not to combine these functions.

Domain 3: Conducting Internal Audit Engagements—Audit Tools and Techniques (28–38%)

1. An audit team developed a preliminary questionnaire with the following response choices:

- Probably not a problem.
- Possibly a problem.
- Probably a problem.

The questionnaire illustrates the use of:

- a. Trend analysis.

Incorrect. Trend analysis is a specialized form of analytical review procedure, used primarily to analyze the changes in account balances over time.

- b. Ratio analysis.

Incorrect. Ratio analysis is a subset of trend analysis used in analytical review. It is unrelated to the subject.

- c. Unobtrusive measures or observations.

Incorrect. Observing means seeing and noticing, not passing over. It implies a careful, knowledgeable look at people and things. It means a visual examination with a purpose, a mental comparison with standards, an evaluative sighting. Use of rating scales requires the participant to actively participate; it is not unobtrusive.

- d. Rating scales.

Correct. The auditors are using a numerical rating scale for the organization audited.

2. Which of the following statements describes an internal control questionnaire? It:

- a. Provides detailed evidence regarding the substance of the control system.

Incorrect. "Yes" and "no" answers may be very general and not specific as to degree.

- b. Takes less of the auditee's time to complete than other control evaluation devices.

Incorrect. Such questionnaires are tiring for auditees to complete due to their length.

- c. Requires that the auditor be in attendance to properly administer it.

Incorrect. The structured questionnaire asks for specific "yes" or "no" answers plus brief explanations.

- d. Provides indirect audit evidence that might need corroboration.

Correct. The evidence provided is indirect and therefore could require corroboration in some way.

3. Which of the following is the **primary** advantage of using an internal control questionnaire?
- a. It provides a clear picture of the interrelationships that exist between the various controls.
Incorrect. This is an advantage of flowcharts.
- b. It reduces the risk of overlooking important aspects of the system.**
Correct. An internal control questionnaire can be prepared in advance and functions very much like a checklist.
- c. It forces an auditor to acquire a full understanding of the system.
Incorrect. This is an advantage of flowcharts.
- d. Negative responses indicate the only areas needing further audit work.
Incorrect. Positive responses must also be tested to determine compliance.
4. Checklists used to assess audit risk have been criticized for all of the following reasons **except**:
- a. Providing a false sense of security that all relevant factors are addressed.
Incorrect. This choice is a criticism of checklists.
- b. Inappropriately implying equal weight to each item on the checklist.
Incorrect. This choice is a criticism of checklists.
- c. Decreasing the uniformity of data acquisition.**
Correct. Checklists increase the uniformity of data acquisition.
- d. Being incapable of translating the experience or sound reasoning intended to be captured by each item on the checklist.
Incorrect. This choice is a criticism of checklists.
5. When an internal auditor is interviewing to gain information, the auditor will not be able to remember everything that was said in the interview. The **most** effective way to record interview information for later use is to:
- a. Write notes quickly, trying to write down everything in detail, as it is said; then highlight important points after the meeting.
Incorrect. Extensive note taking may interfere with communication with respondents, since the auditor cannot maintain eye contact or notice nonverbal as well when occupied taking notes.
- b. Tape-record the interview to capture everything that everyone says; then type everything said into a computer for documentation.
Incorrect. Tape recording might be used for controversial material but generally will not elicit positive feelings from respondents. For most organizational purposes, auditors will not need exact quotes, which are the major benefit of a recording.
- c. Hire a professional secretary to take notes, allowing complete concentration on the interview; then delete unimportant points after the meeting.
Incorrect. Aside from cost, this option would not work because of confidentiality and negative reaction from respondents. This interview is the auditor's job, not someone else's.
- d. Organize notes around topics on the interview plan and note responses in the appropriate area, reviewing the notes after the meeting to make additions.**
Correct. Organizing note taking ahead of time helps auditors have time during the interview to listen and evaluate the responses and the reactions of respondents.

6. When conducting interviews during the early stages of an internal audit, it is more effective to:

a. Ask for specific answers that can be quantified.

Incorrect. Later fieldwork will cover information that can be quantified. Building rapport is more important in the early interviews.

b. Ask people about their jobs.

Correct. Individuals feel more important when they are asked people questions rather than control questions. This will improve the important interpersonal part of building the audit relationship.

c. Ask surprise questions about daily procedures.

Incorrect. Unless fraud is suspected or the audit deals with cash or negotiable securities, it is more effective to defuse the anxiety of anticipating the audit by providing information ahead of time that explains the audit process and how to prepare for it.

d. Take advantage of the fact that fear is an important part of the audit.

Incorrect. Auditee fear may be a natural part of anticipating the audit, but the auditor should keep it from being an important continuing part of the audit by using good interpersonal skills to build a positive participative relationship with auditees.

7. An auditor prepared a working paper that consisted of a list of employee names and identification numbers as well as this statement: "By matching random numbers with employee identification numbers, 40 employee personnel files were selected to verify that they contain all documents required by company policy 501. No exceptions were noted."

The auditor did not place any tick marks on this working paper. Which one of the following changes would improve the auditor's working paper the **most**?

a. Use of tick marks to show that each file was examined.

Incorrect. It is not necessary to use tick marks in this case because the same procedures were applied to all sample selections and no exceptions were detected.

b. Removal of the employee names to protect their confidentiality.

Incorrect. The audit working papers are themselves kept confidential so it is not necessary to remove employee names.

c. Justification for the sample size.

Correct. The working paper should specify the sampling risk and the confidence level or precision achieved by the sample or the method of determining size.

d. Listing of the actual documents examined for each employee.

Incorrect. In this case, reference to the company policy is equivalent to listing the documents that were examined.

8. The standard deviation of a sample will usually decrease with:

a. A decrease in sample size.

Incorrect. A larger sample might more closely approximate the population standard deviation, but that could be either higher or lower depending on the point of reference. A smaller sample might go either way without the increased reliability.

b. The use of stratification.

Correct. Because high-value items can be sampled 100%, a large segment of variability can be eliminated.

c. An increase in desired precision.

Incorrect. To the extent that sample size is affected, the results might be the same as in choice (a).

d. An increase in confidence level.

Incorrect. To the extent that sample size is affected, the results might be the same as in choice (a).

9. Statistical sampling would be appropriate to estimate the value of an auto dealer's 3,000 line-item inventory because statistical sampling is:

a. Reliable and objective.

Correct. This fits the definition.

- b. Thorough and complete.

Incorrect. Statistical sampling is neither thorough nor complete.

- c. Thorough and accurate.

Incorrect. Statistical sampling is neither thorough nor accurate.

- d. Complete and precise.

Incorrect. Statistical sampling is precise but not complete.

10. An important difference between a statistical sample and a judgmental sample is that with a statistical sample:

- a. No judgment is required, everything is by formula.

Incorrect. Judgment is needed for sample size.

- b. A smaller sample size can be used.

Incorrect. A large sample may be needed.

- c. More accurate results are obtained.

Incorrect. There is no way to determine whether more accurate results are obtained.

d. Population estimates with measurable reliability can be made.

Correct. A statistical sample is the only way to measure reliability.

11. Sample size:

- a. Increases with the use of higher confidence levels.**

Correct. In its simplest form, the sample-size formula shows that sample size is equal to $[(\text{Confidence level factor squared} \times \text{Estimated standard deviation squared}) / (\text{Precision squared})]$; thus any increase in confidence level would be accompanied by an increase in sample size.

- b. Decreases with the use of higher confidence levels.

Incorrect. See correct answer (a).

- c. Remains unchanged with changes in confidence levels.

Incorrect. See correct answer (a).

- d. Increases with the use of lower confidence levels.

Incorrect. See correct answer (a).

12. An auditor becomes concerned that fraud in the form of payments to bogus companies may exist. Buyers, who are responsible for all purchases for specific product lines, are able to approve expenditures up to \$50,000 without any other approval. Which of the following audit procedures would be **most** effective in addressing the auditor's concerns?

- a. Use generalized audit software to list all purchases over \$50,000 to determine whether they were properly approved.

Incorrect. This would provide evidence only on purchases above \$50,000, which must be approved by someone other than the buyer.

- b. Develop a snapshot technique to trace all transactions by suspected buyers.

Incorrect. This would provide information only on whether the transactions that were authorized by the buyer were properly processed. It does not provide evidence on whether the transaction should have been processed.

- c. Use generalized audit software to take a random sample of all expenditures under \$50,000 to determine whether they were properly approved.

Incorrect. This would provide information on whether transactions under \$50,000 contained the buyer's authorization. That is not the question here; the question is whether there is support for the expenditure. Further, this procedure is limited because it is not directed to the specific indicators that a fraud might exist.

- d. Use generalized audit software to list all major vendors by product line; select a sample of paid invoices to new vendors and examine evidence which shows that services or goods were received.**

Correct. This is the most comprehensive procedure because it identifies major vendors, concentrates on new vendors, and searches for underlying support that goods or services were provided by the vendor.

13. An auditor wishes to determine the extent to which invalid data could be contained in a human resources computer system. Examples would be an invalid job classification, age in excess of retirement age, or an invalid ethnic classification. The **best** approach to determine the extent of the potential problem would be to:

- a. Submit test data to test the effectiveness of edit controls over the input of data.

Incorrect. Test data would provide evidence on whether the edit controls are currently working. The concern, however, is that data may have entered the system earlier and may be corrupted.

- b. Review and test access controls to ensure that access is limited to authorized individuals.

Incorrect. Access controls are important, but they do not address the auditor's major concern, which is to determine the extent of the potential problem as a precursor for planning the extent to which additional audit work is necessary.

- c. **Use generalized audit software to develop a detailed report of all data outside specified parameters.**

Correct. This is both the most effective and the most efficient procedure as it provides a comprehensive analysis of the extent that obviously incorrect data are included in the database.

- d. Use generalized audit software to select a sample of employees. Use the sample to determine the validity of data items and project the result to the population as a whole.

Incorrect. This is a valid procedure, but given the auditor's more limited objective, choice (c) provides more comprehensive and efficient evidence.

14. A bank internal auditor wishes to determine whether all loans are backed by sufficient collateral, properly aged as to current payments, and properly categorized as current or noncurrent. The **best** audit procedure to accomplish this objective would be to:

- a. **Use generalized audit software to read the total loan file, age the file by last payment due, and take a statistical sample stratified by the current and aged population. Examine each loan selected for proper collateralization and aging.**

Correct. This is the best procedure because it takes a sample from the total loan file and tests to determine that the loan is properly categorized as well as properly collateralized.

- b. Take a block sample of all loans in excess of a specified dollar limit and determine if they are current and properly categorized. For each loan approved, verify aging and categorization.

Incorrect. This sample deals only with large-dollar items and does not test for proper collateralization.

- c. Take a discovery sample of all loan applications to determine whether each application contains a statement of collateral.

Incorrect. This is an inefficient audit procedure because it samples from loan applications, not loans approved.

- d. Take a sample of payments made on the loan portfolio and trace them to loans to see that the payments are properly applied. For each loan identified, examine the loan application to determine that the loan has proper collateralization.

Incorrect. This would be an ineffective procedure because it is based only on loans in which payments are currently being made—it does not include loans that should have been categorized differently because payments are not being made.

15. Governmental auditors have been increasingly called on to perform audits to determine whether individuals are getting extra social welfare payments. One common type of welfare fraud is individuals receiving more than one social welfare payment. This is often accomplished by filing multiple claims under multiple names but using the same address. Which of the following computer audit tools and techniques would be **most** helpful in identifying the existence of this type of fraud?
- a. Tagging and tracing.
Incorrect. Tagging and tracing is most effective to determine that items properly submitted are processed correctly.
- b. Generalized audit software.
Correct. Generalized audit software could be used to develop a list of multiple recipients at one address. The list could then be investigated further to determine the possibility of fraud.
- c. Integrated test facility.
Incorrect. The integrated test facility is most effective to determine that items properly submitted are processed correctly.
- d. Spreadsheet analysis.
Incorrect. This would not be the most effective technique.
16. Management has requested an audit of promotional expenses. The sales department has been giving away expensive items in conjunction with new product sales to stimulate demand. The promotion seems successful, but management believes the cost may be too high. Which of the following audit procedures would be the **least** useful to determine the effectiveness of the promotion?
- a. A comparison of product sales during the promotion period with sales during a similar nonpromotion period.
Incorrect. This comparison would help highlight the effectiveness of the promotion in increasing sales.
- b. **A comparison of the unit cost of the products sold before and during the promotion period.**
Correct. There is no indication that the cost of the products sold has changed. The challenge is to address the effectiveness of the promotion.
- c. An analysis of marginal revenue and marginal cost for the promotion period, compared to the period before the promotion.
Incorrect. This is the key analysis, as it would show the extent of additional revenue versus cost.
- d. A review of the sales department's reasons for believing that the promotion has been successful.
Incorrect. This would be helpful because the sales department may have useful information on new customers and repeat purchases.
17. An internal auditor plans to use an analytical review to verify the correctness of various operating expenses in a division. The use of an analytical review as a verification technique would **not** be a preferred approach if:
- a. **The auditor notes strong indicators of a specific fraud involving this account.**
Correct. If the auditor already suspects fraud, a more directed audit approach would be appropriate.
- b. The company has relatively stable operations that have not changed much over the past year.
Incorrect. Relatively stable operating data are a good scenario for using analytical review.
- c. The auditor would like to identify large, unusual, or nonrecurring transactions during the year.
Incorrect. Analytical review would be useful in identifying whether large, nonrecurring, or unusual transactions occurred.
- d. The operating expenses vary in relation to other operating expenses but not in relation to revenue.
Incorrect. Analytical review only needs to have accounts related to other accounts or other independent data. It does not require that they be related to revenue.

- 18.** During an audit, the internal auditor should consider the following factor(s) in determining the extent to which analytical procedures should be used:
- a. Adequacy of the system of internal control.
Incorrect. Adequacy of the system of internal control would be used to determine the extent of analytical audit procedures to be completed.
 - b. Significance of the area being examined.
Incorrect. The significance of the area being examined would be a factor in determining the extent of the analytical audit procedures to be used.
 - c. Precision with which the results of analytical audit procedures can be predicted.
Incorrect. The precision of the prediction of the internal audit results would be a factor in determining the extent of analytical audit procedures to be used.
 - d. **All of the above.**
Correct. All of the listed factors would be considered in determining the extent of analytical audit procedures to be used.
- 19.** An auditor performs an analytical review by comparing the gross margins of various divisional operations with those of other divisions and with the individual division's performance in previous years. The auditor notes a significant increase in the gross margin at one division. The auditor does some preliminary investigation and also notes that there were no changes in products, production methods, or divisional management during the year. Based on this information, the **most** likely cause of the increase in gross margin would be:
- a. An increase in the number of competitors selling similar products.
Incorrect. An increase in the number of competitors would result in price competition and a likely decrease in gross margin.
 - b. A decrease in the number of suppliers of the material used in manufacturing the product.
Incorrect. A decrease in the number of suppliers would cause less price competition on the incoming side and, all else being equal, would result in a decreased gross margin.
 - c. **An overstatement of year-end inventory.**
Correct. An overstatement of year-end inventory would result in an increase in the gross margin.
 - d. An understatement of year-end accounts receivable.
Incorrect. A decrease in accounts receivable would be very unlikely to signal an increase in the gross margin.
- 20.** During an operational audit, an auditor compares the inventory turnover rate of a subsidiary with established industry standards in order to:
- a. Evaluate the accuracy of the subsidiary's internal financial reports.
Incorrect. Comparison with industry standards will not test the accuracy of internal reporting.
 - b. Test the subsidiary's controls designed to safeguard assets.
Incorrect. Comparison with industry standards will not test the controls designed to safeguard the inventory.
 - c. Determine if the subsidiary is complying with corporate procedures regarding inventory levels.
Incorrect. A comparison with industry standards will not test compliance.
 - d. **Assess the performance of the subsidiary and indicate where additional audit work may be needed.**
Correct. Such an analytical procedure will provide an indication of the efficiency and effectiveness of the subsidiary's management of the inventory.
- 21.** Which of the following is true of a horizontal flowchart as compared to a vertical flowchart?
- a. It provides more room for written descriptions that parallel the symbols.
Incorrect. A vertical flowchart usually is designed to provide for written descriptions.
 - b. **It brings into sharper focus the assignment of duties and independent checks on performance.**
Correct. By emphasizing the flow of processing between departments and/or people, it more clearly shows any inappropriate separation of duties and lack of independent checks on performance.
 - c. It is usually longer.
Incorrect. A horizontal flowchart is usually shorter because space for written descriptions is not provided.
 - d. It does not provide as broad a picture at a glance.
Incorrect. More of the flow of processing can be depicted on one page than in a vertical flowchart with written descriptions.

22. Of the following, which is the **most** efficient source for an auditor to use to evaluate a company's overall control system?
- a. **Control flowcharts.**
Correct. Control flowcharting provides an efficient and comprehensive method of describing relatively complex activities, especially those involving several departments.
- b. Copies of standard operating procedures.
Incorrect. Copies of procedures and related forms do not provide an efficient method of reviewing the processing activities.
- c. A narrative describing departmental history, activities, and forms usage.
Incorrect. A narrative review covering the department's history and forms usage is not as efficient or comprehensive as flowcharting for communicating relevant information about controls.
- d. Copies of industry operating standards.
Incorrect. Industry standards do not provide a picture of existing practice for subsequent audit activity.
23. Which of the following tools would **best** give a graphical representation of a sequence of activities and decisions?
- a. **Flowchart.**
Correct. According to its definition, a flowchart is a graphical representation of a sequence of activities and decisions.
- b. Control chart.
Incorrect. A control chart is used to monitor actual versus desired quality measurements during repetition operation.
- c. Histogram.
Incorrect. A histogram is a bar chart showing conformance to a standard bell curve.
- d. Run chart.
Incorrect. A run chart tracks the frequency or amount of a given variable over time.
24. In documenting the procedures used by several interacting departments, the internal auditor will **most** likely use:
- a. **A horizontal flowchart.**
Correct. A horizontal (systems) flowchart highlights the interaction between departments.
- b. A vertical flowchart.
Incorrect. A vertical flowchart does not highlight the interaction of departments.
- c. A Gantt chart.
Incorrect. A Gantt chart is not a procedure-oriented documenting tool.
- d. An internal control questionnaire.
Incorrect. An internal control questionnaire does not highlight the interaction of departments.
25. Which method of evaluating internal controls during the preliminary review provides the auditor with the **best** visual grasp of a system and a means for analyzing complex operations?
- a. **A flowcharting approach.**
Correct. A flowchart provides a visual grasp of the system and a means of analysis that cannot be achieved by other methods.
- b. A questionnaire approach.
Incorrect. A questionnaire approach provides only an agenda for evaluation.
- c. A matrix approach.
Incorrect. A matrix approach does not provide the visual grasp of the system that a flowchart does.
- d. A detailed narrative approach.
Incorrect. A detailed narrative does not provide the means of evaluating complex operations that a flowchart does.

26. The auditor wishes to test the assertion that all claims paid by a medical insurance company contain proper authorization and documentation, including but not limited to the validity of the claim from an approved physician and an indication that the claim complies with the claimant's policy. The **most** appropriate audit procedure would be to:
- a. Select a random statistical sample of all policyholders and examine all claims for the sampled items during the year to determine if they were handled properly.
Incorrect. Sampling from a population of policyholders would be very inefficient for the audit assertion, as many policyholders may not have any activity during the year.
 - b. Select a sample of claims filed and trace to documentary evidence of authorization and other supporting documentation.
Incorrect. A sample of claims filed does provide evidence on the overall processing of claims and thus provides some evidence related to the assertion. However, given the assertion, choice (a) is more efficient because it deals with paid claims.
 - c. Select a sample of claims denied and determine that all claims denied were appropriate. The claims denied file is much smaller, and the auditor can obtain greater coverage with the sample size.
Incorrect. The claims denied file provides evidence on the claims denied, but the auditor cannot conclude that all claims that were not denied should have been paid.
 - d. **Select a sample of paid claims from the claims (cash) disbursement file and trace to documentary evidence of authorization and other supporting documentation.**
Correct. The auditor is interested in whether the actual claims paid are properly supported. The most appropriate population from which to sample is the claims-paid file.
27. In evaluating the validity of different types of audit evidence, which one of the following conclusions is **incorrect**?
- a. Recomputation, although highly valid, is limited in usefulness due to its limited scope.
Incorrect. This choice is a true statement.
 - b. **The validity of documentary evidence is independent of the effectiveness of the control system in which it was created.**
Correct. The validity of documentary evidence depends on the internal control system.
 - c. Internally created documentary evidence is considered less valid than externally created documentary evidence.
Incorrect. This choice is a true statement.
 - d. The validity of confirmations varies directly with the independence of the party receiving the confirmation.
Incorrect. This choice is a true statement.
28. Which of the following is generally **not** true when evaluating the persuasiveness of evidence?
- a. **Verified by internally maintained documents rather than by written inquiry of third party.**
Correct. Written inquiry/confirmation obtained from outside third parties is more persuasive than internal company documents.
 - b. Obtained under conditions of strong controls rather than weak controls.
Incorrect. Evidence obtained under conditions of strong control is always more persuasive than if controls had been weak.
 - c. Known by an auditor's personal knowledge rather than from a third-party confirmation.
Incorrect. Personal knowledge is generally more persuasive than knowledge obtained from other parties.
 - d. Obtained from an external source rather than from an internal source.
Incorrect. Generally, evidence from outside the organization is more persuasive than evidence obtained from organizational sources. These justifications are based on the general theory of audit evidence.

29. In testing the write-off of a deteriorated piece of equipment, the **best** evidence of the condition of the equipment would be:
- The equipment manager's statement regarding condition.
Incorrect. Testimonial evidence, standing alone, is not conclusive.
 - Accounting records showing maintenance and repair costs.
Incorrect. The record of repair and maintenance costs is an internal record providing little evidence of current condition.
 - A physical inspection of the actual piece of equipment.**
Correct. A physical inspection provides the best evidence of current condition.
 - The production department's equipment downtime report.
Incorrect. As an internal document, the production department's downtime report provides little persuasive evidence of current condition.
30. Which of the following audit procedures provides the **best** evidence about the collectibility of notes receivable?
- Confirmation of note receivable balances with the debtors.
Incorrect. Confirmation establishes existence, not collectibility.
 - Examination of notes for appropriate debtors' signatures.
Incorrect. Inspection helps verify the validity (not collectibility) of the notes.
 - Reconciliation of the detail of notes receivable and the provision for uncollectible amounts to the general ledger control.
Incorrect. This merely tests bookkeeping procedures.
 - Examination of cash receipts records to determine promptness of interest and principal payments.**
Correct. This procedure provides the best evidence of the collectibility of notes receivable.
31. What standard of evidence is satisfied by an original signed document?
- Sufficiency.
Incorrect. Sufficiency has to do with factual, adequate, and convincing evidence. The information contained on the document may be none of those things.
 - Competence.**
Correct. Competent evidence is reliable. It is the best available. An original document is the prime example of such evidence, per the IIA Standards.
 - Relevance.
Incorrect. Relevancy has to do with the relationship of the evidence to some objective of the audit. Since no audit objective is disclosed in the stem of the question, the observer has no way to tell whether the information on the document is or is not relevant to the investigation.
 - Usefulness.
Incorrect. Usefulness is achieved if the item of evidence helps the organization (the auditor, in this case) to accomplish predetermined goals. Since no such goals are specified, there is no way to determine whether the information on the document will help the auditor accomplish some goal established for the audit.
32. When sampling methods are used, the concept of sufficiency of evidence means that the samples selected provide:
- Reasonable assurance that they are representative of the sampled population.**
Correct. A sample need only provide reasonable assurance. Due to of cost/benefit considerations, absolute assurance is not necessary.
 - The best evidence that is reasonably obtainable.
Incorrect. The best reasonably obtainable is a test of competence.
 - Reasonable assurance that the evidence has a logical relationship to the audit objective.
Incorrect. The logical relationship is a test of relevance.
 - Absolute assurance that a sample is representative of the population.
Incorrect. Due to cost/benefit considerations, absolute assurance is not necessary.

33. An internal auditor takes a photograph of the auditee's workplace. The photograph is a form of what kind of evidence?

a. **Physical.**

Correct. All graphic evidence is classified as physical evidence. This includes other forms of graphic evidence, such as graphs, charts, and maps.

b. Testimonial.

Incorrect. Testimonial evidence is restricted to the written response to inquiry or interview.

c. Documentary.

Incorrect. Documentary evidence is nongraphical. It takes the form of records, memoranda, correspondence, and related written material.

d. Analytical.

Incorrect. Analytical evidence is the result of the division of a complex entity into its constituent parts, with the subsequent review of each subset of the original whole.