



*Practice of
Internal Auditing*

CIA PART 2

TEST BANK
QUESTIONS

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MUHAMMAD ZAIN

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PREFACE

All the knowledge possessed by me is a gift from Almighty Allah. The Creator of the Heavens and the earth blessed me with the success of passing Certified Public Accountant (CPA), Certified Management Accountant (CMA), Certified Internal Auditor (CIA), and Masters of Business Administration (MBA) exams in 1st attempt. I am profoundly grateful to my family for providing all the resources and time at their disposal for my enrichment morally, physically, and spiritually. I am also thankful to my teachers, who delivered their knowledge, wisdom, and experience.

The knowledge, resources, views, facts, and information presented in this book are a voice from my heart bestowed by Allah and my experience gained during my entire lifetime. I capitalized hours searching the Internet, Blogs, Social media, and Wikipedia to update my knowledge and notebook as part of my continuous learning objective. I am highly indebted to contributors to Google, Blogs, Social Media, and Wikipedia for presenting me with the ocean of knowledge and insights. The more I dived deep into the ocean, the more I concluded that we human beings are only given limited knowledge, which is unexplored and undiscovered entirely to this date. This curiosity of mankind is bringing innovations, discoveries, and ideas. Any resemblance to any copyrighted material available on the planet is purely coincidental and unintentional. I allow the readers of this book to use it for any related educational purpose and reproduce the contents as long as the original text in this book is unaltered. I give reasonable assurance that the information provided in this book is correct according to my knowledge and belief. There may be circumstances where potential readers challenge the information presented. I welcome these challenges to correct me for future updates.

May the Lord, Master of the day of Judgement and to whom the sovereignty belongs, bless me more and my readers in this world and in particular in life hereafter (Ameen).

CERTIFIED INTERNAL AUDITOR (CIA) - US BASIC INFORMATION

Certified Internal Auditor (CIA) certification is offered by the Institute of Internal Auditors (IIA), US. It is a premium internal auditing qualification having a global presence. CIA is a symbol of excellence in compliance reporting, risk management, and consultancy. CIA has three parts. Part 1 is known as Essentials of Internal Auditing, Part 2 is known as Practice of Internal Auditing, and Part 3 is known as Business Knowledge for Internal Auditing.

Zain Academy's purpose is to create the best CIA Exam Prep materials at affordable pricing.

The IIA releases the profession's primary guidance, such as the International Professional Practices Framework (IPPF), Code of Ethics, International Standards for the Professional Practice of Internal Auditing. Membership with IIA is not required to earn a CIA designation. Candidates can save their earned money by not choosing the membership.

Chapters and affiliated institutes hold regular meetings, seminars, and conferences to develop networking, contacts, and social bonding. It is advisable to attend these types of events to learn about the current practices in internal auditing.

Why Choose CIA

The Certified Internal Auditor (CIA) credential offers many benefits. CIA certification can help you move forward in a focused direction. CIA certification gives a message that you are a proficient internal auditor who can bring valuable insights and experience. CIA holders can be entrusted with significant responsibility. CIA also helps in increasing accounting knowledge and skill.

CIA holders earning potential is excellent as compared to non-certified peers. Companies retain talented individuals by giving them market-based remuneration, bonuses, perks, fringe benefits, vacations. Qualified individuals earning is multiplied if he/she opens consultancy, compliance or internal auditing firm. CIA certified deserves the respect of the peers.

CERTIFIED INTERNAL AUDITOR (CIA) - US BASIC INFORMATION

Way To Achieve CIA Credential

The candidates must meet the four Es requirements, i.e., Education, Ethics, Examination, and Experience for achieving the CIA designation. Three years is provided by the Institute to get certified. However, the candidates can apply for one of the three types of 1-year eligibility extension, i.e., hardship, non-hardship, and exam eligibility. Each type of extension has its procedures and fees. Please refer to the CIA Candidate Handbook as available from the IIA website.

Education – At least a Bachelor's degree from an accredited college or university. If the candidates do not have a bachelor's degree, then a verifiable seven years of internal auditing experience can be accepted.

Ethics – Reflect high moral and professional character and agree to abide by the IIA's Code of Ethics. Submit a Character Reference Form signed by a CIA certified or supervisor or professor.

Examination – This is the most important of all the requirements. Candidates spend considerable time clearing the three parts of the CIA exam.

Experience – Bachelor's degree holder has to demonstrate two years of working experience. However, the requirement is reduced to one year if the candidate is a Master's degree holder. The candidates can fulfill experience requirements even after passing the CIA exams. The experience gained can be in the accounting, finance, or internal audit department.

CERTIFIED INTERNAL AUDITOR (CIA) - US BASIC INFORMATION

CIA Examination

Candidates have to pass three parts to become certified. If a candidate cannot pass all three parts within three years' time period, then the candidate will lose the credit for any part passed and will have to apply again to the Institute. The table is necessary to become familiar with the CIA structure.

Part	Title	MCQs	Time
1	Essentials of Internal Auditing	125	2.5 hours (150 mins)
2	Practice of Internal Auditing	100	2 hours (120 mins)
3	Business Knowledge for Internal Auditing	100	2 hours (120 mins)

IIA Retired Questions

Test Bank Questions available with all the publishers are retired questions by IIA. 75% of the questions are the same with every publisher. The rest, 25%, is their creativity.

REMEMBER that actual CIA exam questions are non-disclosed and are not available to anyone.

CERTIFIED INTERNAL AUDITOR (CIA) - US BASIC INFORMATION

CIA Exam Scoring

The CIA exam is computer-graded. The candidate will receive the result within five minutes of finishing the exam. Scores are determined by the difficulty level of questions asked and converting the value of questions answered correctly to a scale that ranges between 250 to 750. A score of at least 600 is required to pass the exam, i.e., 80%. If the questions are of higher IQ level, the passing score can go below 600, but if the items tested are easy, then passing criteria can go up from 600.

Whether the questions being asked are easy or difficult, I suggest you target achieving an overall 85% in exams by accurately attempting the 85 correct questions out of 100 questions in CIA Part 2.

The trend analysis for several years of CIA exam passing ratio is between 40% to 44%.

CIA Exam Dates

CIA exam can be taken at any day and time of your choice subject to two conditions:

The day must be a normal working day except for weekends and public holidays; and

The time of the exam must be within regular working hours.

It is highly recommended to select your exam date and time as early as possible to get the preferred appointment.

CERTIFIED INTERNAL AUDITOR (CIA) - US BASIC INFORMATION

Documents Required By IIA

The following documents are required by the Institute when a candidate makes a profile at the Certification Candidate Management System (CCMS):

A soft copy of an unexpired official passport or national candidate ID card;

A soft copy of degree and transcripts;

A soft copy of the character reference form duly attested;

A soft copy of the experience reference form verified by a CIA or supervisor.

Once the candidate registers for an exam part and gets the authorization to test email from IIA, he has 180 days to schedule and sit for the exam. This email from IIA must be printed and carried by the candidate when he takes his exam.

Pearson VUE www.pearsonvue.com/iaa conducts CIA examinations globally. Select the testing center location that is easily reachable for you.

CERTIFIED INTERNAL AUDITOR (CIA) - US BASIC INFORMATION

Investment in CIA

Investment in the CIA is one time if the candidates pass all three parts in the first attempt. Investment in the CIA is advantageous throughout life.

CIA exam fee is presented in the following table.

S.No	Description	Member	Non-Member	Student
1.	Application fee	\$ 115	\$ 230	\$ 65
1.	Part 1 fee	\$ 280	\$ 395	\$ 230
1.	Part 2 fee	\$ 230	\$ 345	\$ 180
1.	Part 3 fee	\$ 230	\$ 345	\$ 180
	TOTAL	\$ 855	\$ 1,315	\$ 655

I highly recommend the candidates pay their dues through **DEBIT CARD** only. This way, you will be free from all claims of the bank and will be much relieved. The target must be to clear the exams in 1st Attempt so that the examination fee is paid only once, and benefits of opportunity costs can be derived.

Investment in study materials, test bank questions, and learning videos are separate and vary according to the candidate's preferences and study methods.

REMEMBER to subscribe to the study materials and test bank questions that are economical, comprehensive, updated, and excellent.

ALSO, REMEMBER to subscribe for each part separately to get the time benefit.

CERTIFIED INTERNAL AUDITOR (CIA) - US BASIC INFORMATION

CIA Parts Selection Order

I recommend the candidates to begin their preparation with Part 1 first and then moving to Part 2 and Part 3. The candidates can pass all three parts easily in seven months.

Difficulty Level of CIA Part 2

CIA Part 2 is the wall and roof of all three parts. CIA Part 2 exam can be passed **quickly** if the candidates can exhibit the traits of Excellency, Creativity, Passionate, and Patience in their preparation and, in particular, on exam day.

The Candidates must have a clear vision of their future. They must be able to define their purpose of life. The will to win, the desire to succeed, the urge to reach full potential – these are the keys that will unlock the door of CIA certification.

The reason that many candidates find it difficult to achieve the CIA is that they are not able to define their goals or ever seriously consider them as believable or achievable. Champions can tell you where they are going, what they plan to do along the way, and with whom they will be sharing their adventure.

Keep looking for creativity, and don't settle for the less. You have that potential. It is just a matter of time that you explore and discover yourself. Once you find yourself and your capability, you will never be the same again.

CIA Part 2 – Syllabus

There are four sections in CIA Part 2.

- a. Section A – Managing the Internal Audit Activity – 20% weightage
- b. Section B – Planning the Engagement – 20% weightage
- c. Section C – Conducting Internal Audit Engagements – 40% weightage
- d. Section D – Communicating Engagement Results and Monitoring Progress – 20% weightage

CERTIFIED INTERNAL AUDITOR (CIA) - US BASIC INFORMATION

CIA Part 2 Preparation Time

It is generally observed that many of the CIA candidates are working executives. They have to allocate time for work, family, studies, and personal leisure. The candidates are ready for Part 2 exam if they can allocate at least 3 hours on weekdays and at least 6 hours on weekends for two months continuously.

The candidates must follow the steps to understand the concepts being part of the syllabus of CIA Part 2.

Read a whole particular section from the study book first with the questioning mind approach. Mark or highlight only the important paras or sentences in the book.

Attempt the True / False Questions of that particular section presented in the book to bring clarity on the already read topics.

Attempt the Multiple Choice Questions of that particular section from the Test Bank without any time constraints. Focus must be on selecting the right answers in the first place.

If you attempt any question correctly, proceed to the next question. These questions do not need to be reviewed ever again because a question once attempted successfully will always be correct in the future.

If any question attempted is wrong in the 1st place, then mark or highlight or flag those questions. Furthermore, there might be instances in which you have selected the right answer, but you are in doubt about the outcome of the result if attempted later. These questions also need to be marked or highlighted. These marked questions will form the basis of review, revision, and rehearsal at a later stage.

CERTIFIED INTERNAL AUDITOR (CIA) - US BASIC INFORMATION

CIA Part 2 Preparation Time.....(continued)

Read the explanation of the incorrect answers selected and try to understand the logic of the question and correct answer explanation.

As you complete 80% of the total questions of a particular section, move to the next section, and repeat the steps from (a) to (d).

Revision of the already learned topics every week is warranted. Dedicate a particular day in a week in which you will only revise the already learned topics. Read only those paras from the book which have been highlighted. Attempt only those questions from Test Bank Questions, which have been marked or highlighted. Time Management must come into effect while re-attempting the questions. Each MCQ has to be attempted in 1.2 minutes. This way you will revise the entire section smartly and anxiety level will decrease.

As you complete all the sections of the CIA Part 2, then focus on completing the 100% of the MCQs from the Test Bank Questions.

REMEMBER that each topic has an equal chance of selection in the exam. So you have to be prepared for every concept.

ALSO REMEMBER that CIA Exams are of continuous 2 hour duration. Train your mind to be active for at least 3 hours during MCQs preparation.

CERTIFIED INTERNAL AUDITOR (CIA) - US BASIC INFORMATION

The candidates must have updated study materials and test bank questions. The study materials must be simple, concise, and easy to understand. The majority of finance graduates and working executives prefer self-studies. Select test bank questions of any comprehensive publisher. Subscribing for more than one publisher's test bank questions will not help as most of the questions will be repetitive.

Video Lectures are of great aid. They increase the retention power of the candidates by at least 25%. Furthermore, the candidates can view them later at their ease and convenience. Many of the candidates prefer live classes or online interactive sessions. This can also increase the odds in your favor exponentially.

Recommended Study Approach

CIA exams are computer-based. It is recommended that all your preparation, highlighting, and practice must be on the computer or laptop. The candidates must avoid the traditional method of studying and making notes via pen and paper. Pen and paper shall be used only for calculation-related purposes while attempting the test bank questions.

The candidates can study at any time of day or night, but my preferable time is an early morning daily at 4:30 am. This is the time where the human brain is at a high energy level. This is also the time of great silence.

You will be provided with earplugs in the center and must use them to avoid distractions from other candidates' noise. Silence also has its voice, which you will agree with me on your exam day. Your mind needs to be accustomed to it. Therefore, use good quality foam-based earplugs from day 1 of your preparation. You can find these earplugs from your local pharmacy.

You will be provided with black pens at the center and two sheets. Start using a black pen from day 1. Your mind must be able to recognize and work in a black pen.

Please become familiar with the MCQ screens and navigation of the Pearson VUE Testing Environment before the exams. The tour can be arranged from your computer. This will make you comfortable on your exam day.

CERTIFIED INTERNAL AUDITOR (CIA) - US BASIC INFORMATION

How to Answer the MCQs in preparation and exams?

My preferable way of approaching any MCQ is provided below. Ask yourself three bold phrases in every MCQ.

What are the requirements of the question? The requirements of the question are generally presented in the second last or last line of the question. Read it thoroughly and then reread the whole question to filter out the extra information.

What is the answer? Read twice the answer choices carefully and then select the best answer. Numerical questions require double-checking of formulas and calculations.

If you do not know the answer, make an educated guess. The educated guess is a technique in which you can filter out the two options out of four based on your insights. Now the two options left to be paid attention to. Read the requirements of the question again and then the remaining two answer choices. Select the best one. This way you will increase your odds in favor by 50%.

Attempt all the questions in exams even if the testlet is harder, and time management is crucial. You will not be penalized for any incorrect choices being made. Your score is determined out of correct questions only. Mark or Flag all those questions which you want to review in end if the time allows.

CERTIFIED INTERNAL AUDITOR (CIA) - US BASIC INFORMATION

Pearson VUE Testing Site Visit

After you schedule your appointment with Pearson VUE, visit the center at least three days before the exam to become familiar with the location. If the center is in a building, make yourself familiar with the security perimeters of the building as well. Make contingency plans to reach the exam center in case of any unexpected circumstances. Double-check the weather conditions in advance of the exam day.

Day Before Exam Day

This day is also vital in the candidate's life. Leave all the review, revisions, or attempting the test bank questions at least 24 hours before the exam day. CIA is a professional paper and the candidate has to be ready at any time. You have done enough preparation. Trust in Allah and have confidence in your abilities. You have done enough training. It is now time to showcase your talent.

You will be intimidated to see the materials or revise the test bank questions or watch the lecture videos. Keep aside all these urges. Divert your mind to the most enjoyable activity. That enjoyable activity can be praying, meditating, walking in the garden, or even watching a good movie. Arrange all the required documents, clothes, shoes, calculators, funds, and other items in advance. Charge your cell phone if you plan to travel and navigate by Apps. Mobile Data Connection package must be active. Sleep for at least 10 hours at night before the exam day.

CERTIFIED INTERNAL AUDITOR (CIA) - US BASIC INFORMATION

Activities on Exam Day

Take a good shower and wear comfortable clothing according to the weather conditions.

Have a comprehensive meal that is easily digestible and consume any necessary medicines.

Bring printouts of Authorization Letter / Confirmation Letter / Notice to Schedule received through email from Pearson VUE and Institute, mentioning candidate's name, section part, exam date, time, and venue.

Two original forms of non-expired identification with photograph and signature are required. Therefore, bring an unexpired and signed passport and national identity card / driver's license along with you.

Reach the exam center at least 60 minutes' prior of your appointment time.

Drink coffee or tea before the exam so that you are charged enough.

Visit the washroom before the start of exam.

The mobile phone has to be switched off and placed in a locker along with wallets.

You will not be given any complimentary breaks during the 2 hour exam. However, you can take one for taking a slight break for recharging yourself, visiting the washroom and having water. However, the clock will continue to run.

Do not make noise or stand up from the seat without permission. Raise your hand first. The invigilator will visit you, and then you can ask for pens, extra sheets for working, or taking a break or any malfunction encountered in exams.

Once you finish your exam, review the mark or flagged questions and try to attempt in the remaining time period. Your score is based on the number of questions you answer correctly. You are not penalized for selecting the wrong answer.

Make sure to submit your exam and watch for the incoming message from the system for acknowledging your submitted questions.

What To Do after Passing CIA Exams

Hats off to you for passing all three parts. Meet all other program requirements and complete the Certificate Order Form by logging into CCMS to get your certificate.

LETTER FROM MUHAMMAD ZAIN

26 August 2021

Dear **CIA**,

May Peace, Blessings, and Mercy of Allah be upon you, to all the Messengers of Allah and, in particular, on the Noble and Final Messenger Prophet Muhammad (Peace Be Upon Him), his Family, and his Companions.

Be a symbol of excellence in your life. Always dream big and think beyond the dimensions of the Universe. Man is made to conquer the seven Heavens. Explore the purpose of your existence and discover the enormous potential that is within oneself. Having faith and trust in Creator will give you the light in the darkness and uncharted territories. There is always a silver lining beneath the dark skies. A creative mindset makes life simple. Work on your passion by synchronizing your soul, heart, and mind. We all will die one day, but only a few dare to live the life they wish for.

The Creator has created the entire Universe in six days. There is a great potential to discover the magnificent beauty that remains unexplored to date. This is only possible by seeking knowledge and applying them in our daily lives.

We are living in end times and witnessing a moment that humanity has not ever experienced before. This is the digital transformation age. Artificial Intelligence, Blockchain Technology, Cryptocurrency, Business Intelligence, and Big Data are business norms.

All the information is available in the blink of an eye. Whatever we think in mind comes in front of our screens. These advancements will change the dynamics of the whole world we live in today. All the traditional and so-called “modern” methods of doing work will be replaced by cloud computing. The work of accountants, doctors, engineers, pilots will no longer exist. The irredeemable paper money will be replaced by electronic money. Central Governments will only exist in name only. Universal Government and a unified taxation system will emerge. Virtual reality will be ordinary. Blind will be able to see, deaf will be able to hear, without limbs persons will be able to run, and mentally disabled people will utilize the maximum brain capacity through mental chip implants. Teleportation of humans will be done in a blink of an eye.

LETTER FROM MUHAMMAD ZAIN

My advice to all readers around the world is to focus on entrepreneurship after the certification. This is the only way of survival. Only those businesses are operational who have inelastic demand for their products or services and who are on cloud computing / virtual workplaces. Furthermore, invest surplus funds in real assets such as Gold, Silver, and property. They are the effective hedges against inflation and devaluation. They generate positive returns even in times of economic distress.

I highly recommend that my potential readers pay their interest-bearing debt at the earliest to avoid the debt trap and never go for this easy money for the foreseeable future, even in the form of credit cards. Housing loans are the blood-sucking predator. These are all the means to enslave the human race to limit their thinking and imagination capability. Always spend out of your realized income. Save some funds for your family as a contingency measure.

Allow me the opportunity to present to you the **2022** edition of ***CIA Part 2 Test Bank Questions***. This Test Bank contains the 950 MCQs with explanation to the correct and incorrect choices to help you prepare for CIA exams conducted by IIA.

This CIA Exam Prep is ideal for all persons working in internal auditing, risk management and compliance reporting positions. It also equally suitable for those candidates who wish to learn the concepts and principles of Internal Audit. Aspiring entrepreneurs can also benefit from this CIA review course.

Study with complete dedication and commitment. Make the goal of learning something new and different each day. Replace your fear with curiosity.

LETTER FROM MUHAMMAD ZAIN

Let's work together towards the common goal of earning a Certified Internal Auditor (CIA) credential. My support and guidance will be with you TILL YOU PASS THE EXAMS. Furthermore, you can ask as many questions as you wish to either through WhatsApp (+92 311 222 4261) or email (help@zainacademy.us and help@mzain.org), and I will answer to the best of my ability.

Your work is going to fill a large part of your life and the only way to be truly satisfied is to do what you believe is great work. The only way to do great work is to love what you do. If you haven't found it yet, keep looking. Don't settle. As with all matters of the heart, you will know when you find it.

Have the courage to follow your heart and intuition. They somehow already know what you truly want to become. Everything else is secondary.

Your imagination is everything. It is the preview of life's coming attractions. Only those who believe anything is possible can achieve things most would consider impossible.

Don't let the noise of others' opinions drown out your own inner voice.

Remembering that you are going to die is the best way I know to avoid the trap of thinking you have something to lose. You are already naked. There is no reason not to follow your heart.

LETTER FROM MUHAMMAD ZAIN

Your time is limited, so don't waste it living someone else's life.

I dedicate this work to the Prophet Muhammad (Peace Be Upon Him), Mercy to all the Creation, who has been the source of inspiration and guidance to humanity.

May the Knowledge delivered by me shall be a continuing blessing for me in the Life Hereafter (Ameen).

With Love and Care,

Muhammad Zain

SECTION A - MANAGING THE INTERNAL AUDIT ACTIVITY

This section has weightage of 20% in exams and contains the 205 Multiple Choice Questions (MCQs)

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 1

When the executive management of an organization decided to form a team to investigate the adoption of an activity based costing (ABC) system, an internal auditor was assigned to the team. The best reason for including an internal auditor is the internal auditor's knowledge of

- A. Information processing procedures.
- B. Risk management processes.
- C. Current product cost structures.
- D. Activities and cost drivers.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 1

CORRECT ANSWER IS **B** . Its Explanation is

The internal audit activity (IAA) must evaluate the effectiveness and contribute to the improvement of risk management processes (Standard 2120).

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

It is more likely that the information systems engineer will have more knowledge about the information processing procedures.

Explanation for Choice C:

It is more likely that an engineer will have more knowledge about the production cost structures.

Explanation for Choice D:

It is more likely that an engineer will have more knowledge about the activities and cost drivers.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 2

In most organizations, the rapidly expanding scope of internal auditing responsibilities requires continual training. What is the main purpose of such a training program?

- A. To achieve both individual and organizational goals.
- B. To help individuals to achieve personal career goals.
- C. To comply with continuing education requirements of professional organizations.
- D. To use slack periods in engagement scheduling.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 2

CORRECT ANSWER IS **A** . Its Explanation is

The primary purpose of training is so both individual and organizational goals can be achieved.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Both personal and the goals of the IAA should be achieved, not just the individual's.

Explanation for Choice C:

The primary purpose of continuing education is so both individual and organizational goals can be achieved, not to meet the education requirements of the professional organizations.

Explanation for Choice D:

Training courses can be scheduled during slack time, but this is not the primary purpose.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 3

The following are good techniques for providing feedback:

- I. Focusing on specific behaviors.
- II. Keeping feedback personal.
- III. Directing negative feedback toward behavior, which is controllable by the recipient.
- IV. Making feedback well timed.

- A. I and II only.
- B. I, III and IV only.
- C. I, II, III and IV.
- D. II, III and IV only.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 3

CORRECT ANSWER IS **B** . Its Explanation is

Items I, III and IV are good feedback techniques. Feedback should be specific rather than general. Feedback is useful if negative feedback is directed toward behavior, which is controllable by the recipient. There is little value in reminding a person of some shortcoming over which he or she has not control.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Item I is a good technique for providing feedback. Item II is not a good feedback technique because feedback should be impersonal. It should be descriptive rather than judgmental or evaluative.

Explanation for Choice C:

Items I, III and IV are good feedback techniques. Item II is not a good feedback technique because feedback should be impersonal. It should be descriptive rather than judgmental or evaluative.

Explanation for Choice D:

Item III and IV are good techniques for providing feedback. Item II is not a good feedback technique because feedback should be impersonal. It should be descriptive rather than judgmental or evaluative.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 4

Which phrase best describes a control-based control self-assessment process?

- A. Analyzing the gap between control design and control frameworks.
- B. Evaluating, updating, and streamlining selected control processes.
- C. Examining how well controls are working in managing key risks.
- D. Determining the cost-effectiveness of controls.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 4

CORRECT ANSWER IS **C** . Its Explanation is

A control-based format focuses on how well the controls in place are working. The aim of the workshop is to produce an analysis of the gap between how controls are working and how well management expects those controls to work. An important aspect of this workshop is identifying the key risks and controls before the beginning of the workshop. Then during the workshop, the work team assesses how well the controls mitigate risks.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Analyzing the gap between control design and control framework does not adequately describe a control-based process.

Explanation for Choice B:

This situation describes a process-based approach.

Explanation for Choice D:

Determining the cost-effectiveness of controls is not the primary focus of the control-based process.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 5

During a review of purchasing operations, an auditor found that procedures in use did not agree with stated company procedures. However, audit tests revealed that the procedures in use represented an increase in efficiency and a decrease in processing time, without a discernible decrease in control. The auditor should

- A. Suspend the completion of the audit until the auditee documents the new procedures.
- B. Develop a flowchart of the new procedures and include it in the report to management.
- C. Report the lack of adherence to documented procedures as an operational deficiency.
- D. Report the change and suggest that the change in procedures be documented.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 5

CORRECT ANSWER IS **D** . Its Explanation is

This represents a change in process that should be brought to the attention of management and documented.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The audit should be completed.

Explanation for Choice B:

A flowchart is not the best form of documentation because it does not address efficiency.

Explanation for Choice C:

The procedures do not represent a deficiency since efficiency has improved without diminishing control.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 6

An auditor is scheduled to audit payroll controls for a company that has recently outsourced its processing to an information service bureau. What action should the auditor take, considering the outsourcing decision?

- A. Cancel the engagement, because the processing is being performed outside of the organization.
- B. Review the controls over payroll in both the company and the service bureau.
- C. Review only the company's controls over data sent to and received from the service bureau.
- D. Review only the controls over payments to the service bureau based on the contract.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 6

CORRECT ANSWER IS **B** . Its Explanation is

Engagements involving third parties are necessary when transactions requiring vital controls are being processed outside the organization such as the outsourcing of the entity's payroll function to a service bureau. Control risk may be higher because the external organization's controls are part of the organization's internal control structure. Thus, the internal auditor should review the controls over payroll in both the company and the service bureau.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Controls should be evaluated regardless of their location.

Explanation for Choice C:

There should be a review of both organizations' controls.

Explanation for Choice D:

Reviewing controls over payments based on the contract narrows the scope of the engagement.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 7

Staff members of the internal audit activity (IAA) should be assigned to engagements and training projects that will enable them to develop their potential. Which of the following should be the most important consideration in making assignments that will allow staff members to develop properly?

- A. Special interests of individual staff members.
- B. The importance of giving all staff members extensive supervisory experience.
- C. Specific training requirements imposed by the Standards.
- D. The skills and experience levels of individual auditors.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 7

CORRECT ANSWER IS **D** . Its Explanation is

The skills and experience levels of the individual auditors are probably the most important characteristics taken into account in the assignment of staff to individual engagements. The staff assigned to the job must have the necessary skills and experience to be able to complete that engagement.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The special interests of staff members may be a criteria in the assignment of staff to engagements, but it is not the most important consideration. Staff need to be assigned to jobs that will provide them the necessary skills and experience to grow professionally, even if these are not jobs that they have a special interest in.

Explanation for Choice B:

Not all staff will be able to have extensive supervisory experience as not all staff are in supervisory positions or are ready to be supervisors.

Explanation for Choice C:

The Standards do not impose specific training requirements.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 8

An organization is identifying engagements to be performed by the internal audit activity over the next 3 to 5 years.

The result is an example of

- A. A strategic engagement plan.
- B. A planned engagement goal.
- C. A tactical engagement plan.
- D. An engagement planning objective.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 8

CORRECT ANSWER IS **A** . Its Explanation is

Strategic engagement plans are prepared for more than a one-year period. The strategic plan is needed to help ensure that all areas of the business are audited at least periodically. Some areas (those with the most assessed risk) will need to be audited annually, or even more often, while other areas may be addressed once every two or three years.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Goals are achieved by executing the plans.

Explanation for Choice C:

Tactical engagement plans are of shorter-term than strategic plans.

Explanation for Choice D:

Objectives are achieved by executing the plans.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 9

Internal auditors are increasingly called on to perform audits related to an organization's environmental stewardship.

Which of the following does not describe the objectives of a type of environmental audit?

- A. Determine whether environmental management systems are in place and operating properly to manage future environmental risks.
- B. Determine whether the organization's current actions are in compliance with existing laws.
- C. Determine whether environmental issues are considered as part of economic decisions.
- D. Determine whether the organization is focusing efforts on ensuring that its products are environmentally friendly, and confirm that product and chemical restrictions are met.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 9

CORRECT ANSWER IS **C** . Its Explanation is

Determining whether environmental issues are considered part of economic decisions would not be an objective of an environmental audit.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

An objective of an environmental audit could be to determine whether environmental management systems are in place and operating properly to manage future environmental risks.

Explanation for Choice B:

An objective of an environmental audit could be to determine whether the organization's current actions are in compliance with existing laws.

Explanation for Choice D:

An objective of an environmental audit could be to determine whether the organization focuses efforts on ensuring that its products are environmentally friendly and confirms that product and chemical restrictions are met.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 10

Today there is expected to be a high level of open and candid communication between the CAE and the audit committee. Which of the following communication activities should the CAE provide to the audit committee?

- I. Keep the audit committee informed of emerging trends and successful practices in internal auditing.
- II. Issue periodic reports to the audit committee and management summarizing results of audit activities.
- III. Review information submitted to the audit committee for completeness and accuracy.
- IV. The safeguarding of assets.

- A. I, II, III and IV.
- B. II, III and IV only.
- C. I, II and III only.
- D. I only.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 10

CORRECT ANSWER IS **C** . Its Explanation is

If the CAE is to be viewed as a trusted advisor by the committee, communications is the key element. The CAE should consider providing communications to the audit committee in the following areas, including keeping the audit committee informed of emerging trends and successful practices in internal auditing; issuing periodic reports to the audit committee and management summarizing results of audit activities; and reviewing information submitted to the audit committee for completeness and accuracy.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Safeguarding of assets is management's responsibility, not the CAE's or audit committees.

Explanation for Choice B:

Safeguarding of assets is management's responsibility, not the CAE's or audit committees.

Explanation for Choice D:

The CAE should also issue periodic reports to the audit committee and management, and review information submitted to the audit committee for completeness and accuracy.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 11

The function of internal auditing, as related to internal financial reports, would be to

- A. Review the expenditure items and match each item with the expenses incurred.
- B. Ensure compliance with reporting procedures.
- C. Determine if there are any employees expending funds without authorization.
- D. Identify inadequate controls that increase the likelihood of unauthorized expenditures.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 11

CORRECT ANSWER IS **D** . Its Explanation is

Internal auditors are responsible for identifying inadequate controls, for appraising managerial effectiveness, and for pinpointing common risks.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

There is no expected match of funds flows with expense items in a single time period.

Explanation for Choice B:

The *Standards* does not require internal auditors to ensure compliance with reporting procedures.

Explanation for Choice C:

This would be a function of the personnel and/or finance departments.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 12

Which of the following directives would be most useful to a sales department manager in controlling and evaluating the performance of the manager's customer service group?

- A. Customer complaints should be processed promptly.
- B. All customer inquiries should be answered within seven days of receipt.
- C. Employees should maintain a positive attitude when dealing with customers.
- D. The customer is always right.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 12

CORRECT ANSWER IS **B** . Its Explanation is

Performance can be measured against the "seven days" standard to see if the objective is being met.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

An inadequate measure has been specified to the employee.

Explanation for Choice C:

No measure of positive attitude has been specified for the employee.

Explanation for Choice D:

No standard has been set by which to measure employee perfection.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 13

Which of the following is a necessary part of a program for selecting and developing internal audit activity (IAA) staff?

- A. Developing a written job description for each level of the staff.
- B. Requiring a written examination prior to employment.
- C. Specifying that an accounting degree is necessary for employment.
- D. Counseling each member of the staff on career opportunities.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 13

CORRECT ANSWER IS **A** . Its Explanation is

Job (position) descriptions facilitate recruiting by: (a) stating explicit job requirements; (b) providing objective promotion criteria; (c) used to justify adequate salaries; (d) express organizational expectations of employees; and (e) compel the IAA to engage in personnel planning.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Written examinations are not part of the program of selecting and developing IAA staff.

Explanation for Choice C:

Accounting degrees are necessary if the internal auditor is engaged in analyzing financial and accounting data. But, in some cases the IAA may need a different type of specialist.

Explanation for Choice D:

Counseling should be done in regards to enhancing the internal auditors job performance, not career opportunities.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 14

At a meeting with engagement managers, the chief audit executive (CAE) is allocating the engagement work schedule for next year's plan. Which of the following methods will ensure that each manager receives an appropriate share of both the work schedule and internal audit activity resources?

- A. Each of the managers' selects the individual assignments desired, based on preferences for the area and the management personnel involved.
- B. The full list of scheduled engagements is published for the staff, and work assignments are made based on career interests and travel requirements.
- C. Each manager chooses assignment preferences based on the total staff hours that are currently available to each manager.
- D. Work is assigned to each manager based on risk and skill analysis.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 14

CORRECT ANSWER IS **D** . Its Explanation is

The matters to be considered in establishing engagement work schedule priorities should include updated assessments of risks and effectiveness of risk management and control processes and changes to and capabilities of the audit staff.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Personal preferences are not a basis for deciding assignments.

Explanation for Choice B:

Assignments for engagements are not based on career interest and travel requirements, although they may be staffing issues.

Explanation for Choice C:

Available staff hours are not a basis for deciding risk or skill level necessary for assignments.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 15

There are three primary Control Self-Assessment (CSA) approaches. Which one of these approaches entails gathering information from work teams that represent different levels in the business unit or function?

- A. Controller-produced analysis.
- B. Facilitated team workshops.
- C. Questionnaires/Surveys.
- D. Management-produced analysis.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 15

CORRECT ANSWER IS **B** . Its Explanation is

Facilitated team workshop is the process of gathering information from work teams that represent different levels in the business unit or function. The primary format of the workshop may be based on objectives, risks, controls or processes.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Controller-produced analysis is not designed to gather information from work teams.

Explanation for Choice C:

Surveys or questionnaires tend to ask simple "Yes or No" questions.

Explanation for Choice D:

Management-produced analysis covers the other approaches by management groups to produce information about business processes, risk management activities and control procedures.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 16

The primary difference between operational engagements and financial engagements is that in the former the internal auditors

- A. Start with the financial statements of the client entity and works backward to the basic processes involved in producing them.
- B. Can use analytical skills and tools that are not necessary in financial engagements.
- C. Are seeking to help management use resources in the most effective manner possible.
- D. Are not concerned with whether the client entity is generating information in compliance with financial accounting standards.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 16

CORRECT ANSWER IS **C** . Its Explanation is

The primary difference between financial and operational engagements is that in the former the internal auditor is seeking to form an opinion on the fairness of the financial statements, whereas operational engagements involve evaluating the efficiency and economical use of the organization's resources.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Internal auditors start with the financial statements and work back when conducting a financial engagement.

Explanation for Choice B:

Analytical skills and tools are necessary in financial engagements.

Explanation for Choice D:

Internal auditors are concerned with the integrity and reliability of presented financial reports. Making sure the presented financial statements are in accordance with accounting standards is important in operational engagements.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 17

An internal audit activity's staff development program will be deficient if individual employees are

- A. Expected to study current events on an independent basis.
- B. Given a large variety of tasks to perform.
- C. Assigned to a different supervisor on each job.
- D. Formally evaluated once every 2 years.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 17

CORRECT ANSWER IS **D** . Its Explanation is

Each internal auditor's performance should be appraised at least annually. The CAE should also provide counseling to internal auditors on their performance and professional development.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Studying a variety of events is a method to expand the internal auditors training and experience.

Explanation for Choice B:

Given a large variety of tasks is a method to expand the internal auditors training and experience.

Explanation for Choice C:

The rotation of supervisors would be a chance to expand the internal auditors training and experience.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 18

Which internal audit planning tool is general in nature and is used to ensure adequate engagement coverage over time?

- A. The engagement work program.
- B. The internal audit activity's charter.
- C. The internal audit activity's budget.
- D. The long-range (strategic) plan.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 18

CORRECT ANSWER IS **D** . Its Explanation is

The long-term or strategic plan is general in design, but should ensure that all areas of the business are audited at least periodically.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The engagement work program is limited in scope to a particular assignment.

Explanation for Choice B:

The Charter is not an internal auditor's planning tool.

Explanation for Choice C:

A budget is used to allocate resources, but is not used to ensure engagement coverage over the long run.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 19

An engagement work schedule for the internal audit activity (IAA) is an essential part of

- A. Planning for the internal audit activity.
- B. Scheduling support for the external audit.
- C. Providing senior management with information about the quality of the internal audit activity's performance.
- D. Establishing standards for employee performance.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 19

CORRECT ANSWER IS **A** . Its Explanation is

The planning process involves establishing goals, engagement work schedules, staffing plans and financial budgets, and activity reports. Engagement work schedules should include what activities are to be performed; when they will be performed; and the estimated time required, taking into account the scope of the engagement work planned and the nature and extent of related work performed by others.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

The engagement work schedule is not an essential part to support the external audit.

Explanation for Choice C:

The activity report would provide better information on the quality of the IAA's performance, not the engagement work schedule.

Explanation for Choice D:

Management sets establishing standards for employee performance.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 20

Policies and procedures relative to managing the internal audit activity should

- A. Ensure compliance with its performance standards.
- B. Result in consistent job performance.
- C. Prescribe the format and distribution of engagement communications and the classification of engagement observations.
- D. Give consideration to its structure and the complexity of the work performed.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 20

CORRECT ANSWER IS **D** . Its Explanation is

The form and content of written policies and procedures should be appropriate to the size and structure of the IAA and the complexity of its work.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Complying with performance standards is a quality issue, and policies and procedures will not necessarily ensure compliance with performance standards.

Explanation for Choice B:

Policies and procedures in themselves will not result in consistent job performance.

Explanation for Choice C:

Policies and procedures provide general guidelines whereas prescribing the format and distribution of engagement communications and classification of engagement observations are discretionary measures that will depend on the size and structure of the IAA.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 21

Coordination between internal and external auditors can reduce the overall costs of the external audit. Who is actually responsible for coordinating the internal and external auditing efforts?

- A. The board.
- B. Management.
- C. The external auditor.
- D. The Chief Audit Executive.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 21

CORRECT ANSWER IS **D** . Its Explanation is

The CAE should share information and coordinate activities with other internal and external providers of relevant assurance and consulting services to ensure proper coverage and minimize duplication of efforts (Standard 2050).

Thus, proper coordination of internal and external auditing functions can help to reduce costs.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The board has oversight authority, but is not directly responsible for coordinating internal and external auditing efforts.

Explanation for Choice B:

Management is not responsible for coordinating internal and external auditing efforts.

Explanation for Choice C:

The external auditor is not responsible for coordinating internal and external auditing efforts.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 22

Which of the following are true regarding internal auditors and the adequacy of an organization's risk management process?

- I. Internal auditors must have must have an understanding of the risk assessment process and the tools used to make the assessment.
- II. Internal auditors should determine the level of risks acceptable to the organization.
- III. Internal auditors need to be satisfied that the key objectives of risk management processes are being met
- IV. Internal auditors should evaluate management's risk processes the same way they analysis risk when planning an engagement.

- A. I and III only.
- B. I, II and III only.
- C. I and II only.
- D. I, II, III and IV.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 22

CORRECT ANSWER IS **A** . Its Explanation is

Items I and III are true. Internal auditors must have an understanding of the risk assessment process and the tools used to make the assessment, and they also need to be satisfied that the key objectives of risk management processes are being met.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Item II is not true. Management, not internal auditors determine the level of risks acceptable to the organization.

Explanation for Choice C:

Item I is true. Internal auditors must have an understanding of the risk assessment process and the tools used to make the assessment.
Item II though is not true. Management, not internal auditors determine the level of risks acceptable to the organization.

Explanation for Choice D:

Item IV is also not true. Evaluating management's risk processes is different than the requirement that auditors use risk analysis to plan audits. However, information from a comprehensive risk management process, including the identification of management and the board concerns, can assist the internal auditor in planning audit activities.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 23

An organization has two manufacturing facilities. Each facility has two manufacturing processes and a separate packaging process. The processes are similar at both facilities. Raw materials used include aluminum, materials to make plastic, various chemicals, and solvents. Pollution occurs at several operational stages, including raw materials handling and storage, process chemical use, finished goods handling, and disposal. Waste products produced during the manufacturing processes include several that are considered hazardous. The nonhazardous waste is transported to the local landfill. An outside waste vendor is used for the treatment, storage, and disposal of all hazardous waste. Management is aware of the need for compliance with environmental laws. The organization recently developed an environmental policy including a statement that each employee is responsible for compliance with environmental laws. Management is exploring different ways of reducing or preventing pollution in manufacturing operations. The objective of a pollution prevention audit is to identify opportunities to minimize waste and eliminate pollution at the source. In what order should the following opportunities to reduce waste be considered?

- I. Recycling and reuse
 - II. Elimination at the source
 - III. Energy conservation
 - IV. Recovery as a usable product
 - V. Treatment
-
- A. III, IV, II, V, and I.
 - B. I, III, IV, II, and V.
 - C. V, II, IV, I, and III.
 - D. IV, II, I, III, and V.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 23

CORRECT ANSWER IS **D** . Its Explanation is

The hierarchy should be usable products, source reduction, recycling, and reuse. Treatment in this hierarchy would be last.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The hierarchy should be usable products, source reduction, recycling, and reuse.

Explanation for Choice B:

The hierarchy should be usable products, source reduction, recycling, and reuse.

Explanation for Choice C:

If the objective of the audit is to identify opportunities to minimize waste and eliminate pollution at the source then the hierarchy should be usable products, source reduction, recycling, and reuse. Treatment would not be the first item to be considered.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 24

A specific objective of an audit of a company's expenditure cycle is to determine whether all goods paid for have been received and charged to the correct account. This objective addresses which of the following primary objectives identified in the *Standards*?

- I. Reliability and integrity of financial and operational information.
- II. Compliance with laws, regulations, and contracts.
- III. Effectiveness and efficiency of operations.
- IV. Safeguarding of assets.

- A. II, III and IV only.
- B. I, II and IV only.
- C. I and IV only.
- D. I and II only.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 24

CORRECT ANSWER IS **C** . Its Explanation is

The engagement objective of determining whether all goods paid for have been received and charged to the correct account have to do with the objective regarding the reliability and integrity of financial and operational information, and the objective regarding the safeguarding of assets.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Complying with laws, regulations, and contracts and addressing effectiveness and efficiency of operations are not part of the engagement objective.

Explanation for Choice B:

Complying with laws, regulations, and contracts is not part of the engagement objective.

Explanation for Choice D:

Complying with laws, regulations, and contracts is not part of the engagement objective.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 25

The chief audit executive (CAE) is responsible for establishing a program to develop the human resources of the internal audit activity (IAA). This program should include

- A. Continuing educational opportunities and performance appraisals.
- B. An established training plan and a charter.
- C. Job descriptions and competitive salary increases.
- D. Counseling and an established career path.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 25

CORRECT ANSWER IS **A** . Its Explanation is

Continuing education and performance appraisals are good methods of developing the IAA staff.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Training would be part of the human resource development plan, but the charter is not specific.

Explanation for Choice C:

Job (position) descriptions would be part of the human resource development plan, but competitive salary increases are not.

Explanation for Choice D:

Counseling would be part of the human resource development plan, but establishing a career path is not.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 176

CORRECT ANSWER IS **D** . Its Explanation is

The long-range schedule provides evidence of coverage of key functions at planned intervals.

INCORRECT CHOICES EXPLANATION

Explanation for A:

The engagement program is limited in scope to a particular project.

Explanation for B:

The audit activity's budget may be used to justify the number of audit personnel, but it is not used to ensure adequate audit coverage over time.

Explanation for C:

The audit activity's charter is not an engagement-planning tool.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 178

Which of the following is the best reason for the CAE to consider the strategic plan in developing the annual audit plan?

- A. To ensure that the internal audit plan supports the overall business objectives.
- B. To ensure that the internal audit plan will be approved by senior management.
- C. To emphasize the importance of the internal audit activity.
- D. To make recommendations to improve the strategic plan.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 178

CORRECT ANSWER IS **A** . Its Explanation is

Considering the strategic plan in the development of the internal audit plan will ensure that the audit objectives support the overall business objectives stated in the strategic plan.

INCORRECT CHOICES EXPLANATION

Explanation for B:

This action may make the internal audit plan fit better with the strategic plan but may not have an effect on management's approval.

Explanation for C:

Although the importance of the internal audit activity may be increased by such action, this is not the primary reason for the action.

Explanation for D:

Although the CAE may make recommendations to improve the strategic plan, this is not the primary purpose of the CAE reviewing the plan.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 179

If the annual audit plan does not allow for adequate review of compliance with all material regulations affecting the company, the internal audit activity should:

- A. Decrease the scope of operational and financial audits to make additional audit time available.
- B. Include a memo with the audit planning file listing the reasons for the lack of coverage.
- C. Document that regulations not included will be reviewed in the subsequent year.
- D. Ensure that the board of directors and senior management are aware of the limitation.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 179

CORRECT ANSWER IS **D** . Its Explanation is

Senior management and the board of directors should be informed of the implications of gaps in audit coverage, including the review of compliance with applicable laws and regulations.

INCORRECT CHOICES EXPLANATION

Explanation for A:

Audit coverage in other areas should not be automatically reduced. The internal audit activity may require additional resources to provide adequate coverage of risks.

Explanation for B:

The knowledge of incomplete audit coverage should not be known only to the internal audit activity.

Explanation for C:

Compliance with material regulations may need to be reviewed annually.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 180

Depending on the size and complexity of the organization's business activities, risk management processes can be

- A. Formal or informal.
- B. Embedded in the business units or centralized at the corporate level.
- C. Quantitative or subjective.
- D. All of the above.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 180

CORRECT ANSWER IS **D** . Its Explanation is

Risk management processes can be formal or informal, or they can be quantitative or subjective; or they can be embedded in the business units or centralized at the corporate level. Therefore, all of the above are part of the risk management process.

INCORRECT CHOICES EXPLANATION

Explanation for A:

This is part of the risk management process.

Explanation for B:

This is part of the risk management process.

Explanation for C:

This is part of the risk management process.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 181

When a risk assessment process has been used to construct an audit engagement schedule, which of the following should receive attention first?

- A. The external auditors have requested assistance for their upcoming annual audit.
- B. Management has requested an investigation of possible lapping in receivables.
- C. A new accounts payable system is currently undergoing testing by the IT department.
- D. The existing accounts payable system has not been audited over the past year.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 181

CORRECT ANSWER IS **B** . Its Explanation is

Management's request to investigate a possible fraud in the accounts receivable unit must take precedence over the other entities.

INCORRECT CHOICES EXPLANATION

Explanation for A:

External audit requests to assist with fieldwork should be subordinate to fraud investigations.

Explanation for C:

Because the new system is not yet in production, this can wait.

Explanation for D:

A management request involving a fraud should take priority over a system that has not been audited over the past year.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 182

In a well-developed management environment, the internal audit activity would:

- A. Report the results of an audit engagement to line management as well as to senior management.
- B. Conduct initial audits of new computer systems after they have begun operating.
- C. Interface primarily with senior management, minimizing interactions with line managers who are the subjects of internal auditwork.
- D. Focus primarily on asset management and report results to the audit committee.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 182

CORRECT ANSWER IS **A** . Its Explanation is

In a well-developed management system, the internal audit activity is used to provide a more direct benefit to line operations by providing feedback to operating management as well as to senior management.

INCORRECT CHOICES EXPLANATION

Explanation for B:

Emphasis should be placed on the audits of proposed products and systems. These early examinations could be used to determine the feasibility and/or desirability of changes before these changes are implemented.

Explanation for C:

The role of the internal auditor involves interfacing with management at the operating level as well as at the senior level.

Explanation for D:

Asset management would not be a primary focus of the internal audit activity.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 183

The first phase of the risk assessment process is to identify and catalog the auditable activities of the organization. Which of the following would not be considered an auditable activity?

- A. Statutory laws and regulations as they affect the organization.
- B. General ledger account balances.
- C. Computerized information systems.
- D. The agenda established by the audit committee for one of its quarterly meetings.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 183

CORRECT ANSWER IS **D** . Its Explanation is

The audit committee's agenda for an audit committee meeting would not be an auditable activity, but may contain audit activities conducted by the internal auditing activity (IAA) .

INCORRECT CHOICES EXPLANATION

Explanation for A:

This is an auditable activity specifically identified in the *Standards* (2120.A1).

Explanation for B:

This is an auditable activity specifically identified in the *Standards* (2120.A1).

Explanation for C:

This is an auditable activity specifically identified in the *Standards* (2120.A1).

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 184

Which of the following comments is correct regarding the assessment of risk associated with two projects that are competing for limited audit resources?

- I. Activities that are requested by the audit committee should always be considered higher risk than those requested by management.
- II. Activities with higher dollar budgets should always be considered higher risk than those with lower dollar budgets.
- III. Risk should always be measured by the potential dollar or adverse exposure to the organization.

- A.III only.
- B.I and III only.
- C.II only.
- D.I only.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 184

CORRECT ANSWER IS **A** . Its Explanation is

- I. Incorrect. Requests from management and the audit committee should both be considered by the internal audit activity. Although an audit committee request is important, it is not always more important, nor does it always imply higher risk.
- II. Incorrect. Risk is measured by the potential exposure to the organization. The size of the departmental budget is an important determinant but is not a sufficient determinant.
- III. Correct. Practice Advisory 2010-1 advises that the degree of exposure is an important component of risk.

INCORRECT CHOICES EXPLANATION

Explanation for B:

See the correct answer for an explanation.

Explanation for C:

See the correct answer for an explanation.

Explanation for D:

See the correct answer for an explanation.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 185

The following are potential sources of evidence regarding the effectiveness of the division's total quality management program. Assume that all comparisons are for similar time periods and duration and current items are compared with similar items before the implementation of the total quality management program. The least persuasive evidence would be a comparison of

- A. Scrap and rework costs over the two time periods.
- B. Employee morale over the two time periods.
- C. Customer returns over the two time periods.
- D. Manufacturing and distribution costs per unit over the two time periods.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 185

CORRECT ANSWER IS **B** . Its Explanation is

Employee morale is important and often is a side-benefit of total quality management programs. However, employee morale is not a sufficient reason to implement TQM: there should be some evidence of greater customer satisfaction or reduced costs.

INCORRECT CHOICES EXPLANATION

Explanation for A:

Reduction in scrap should be one of the outcomes as TQM is implemented.

Explanation for C:

TQM should lead to product quality improvements resulting in a lower level of customer returns.

Explanation for D:

TQM should help to reduce costs.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 186

Which statement most accurately describes how criteria are established for use by internal auditors in determining whether goals and objectives have been accomplished?

- A. Management is responsible for establishing the criteria.
- B. Appropriate accounting or auditing standards, including international standards, should be used as the criteria.
- C. The industry in which a company operates establishes criteria for each member company through benchmarks and best practices for that industry.
- D. Internal auditors should use professional standards or government regulations to establish the criteria.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 186

CORRECT ANSWER IS **A** . Its Explanation is

When the internal auditor is determining whether or not goals and objectives have been met, the internal auditor should use goals and objectives that have been created by management. It is these goals set by management that the internal auditor will be assessing whether or not they have been completed. This is supported by Practice Advisory 2120-1.

INCORRECT CHOICES EXPLANATION

Explanation for B:

Accounting or auditing standards would not be appropriate for this purpose.

Explanation for C:

These are sources of information that will assist management in establishing goals and objective, relevant, meaningful criteria.

Explanation for D:

In instances where management has not established the criteria, or if, in the auditor's opinion, the established criteria are judged less than adequate, the auditor should work with management to develop appropriate evaluation criteria.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 187

Which of the following is a major element of the ISO 9000:2012 quality management system standards?

- A. The assessment of the risk that objectives are not achieved.
- B. The attitude and actions of the board and management regarding the significance of control within the organization.
- C. The principle that improved employee satisfaction will lead to increased productivity.
- D. A requirement for organizations to monitor information on customer satisfaction as a measure of performance.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 187

CORRECT ANSWER IS **D** . Its Explanation is

This is one of the major changes to the ISO 9000 standards made in the 2000 revision.

INCORRECT CHOICES EXPLANATION

Explanation for A:

The ISO 9000 approach does not take a risk assessment approach; a risk assessment approach is what underlies internal auditing.

Explanation for B:

This is the control environment as defined in the glossary of The IIA's Standards; there is no direct reference to any such concept in the ISO 9000 standards.

Explanation for C:

This is not a part of the ISO 9000 standards. ISO argues that following the eight management principles that underlie the ISO9000 standards will lead to improved employee satisfaction.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 188

Which of the following factors is least essential to a successful control self-assessment workshop?

- A. Voting technology.
- B. Group dynamics.
- C. Facilitation training.
- D. Prior planning.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 188

CORRECT ANSWER IS **A** . Its Explanation is

Manual forms of recording views and giving group feedback are effective; voting technology can increase the efficiency, but it is not essential to success.

INCORRECT CHOICES EXPLANATION

Explanation for B:

CSA facilitators need to understand and manage group dynamics.

Explanation for C:

CSA requires facilitation skills.

Explanation for D:

CSA requires careful planning.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 189

An internal auditor has been asked to review the treasury department's compliance with corporate policy related to the use of forward trading to manage currency valuation risk. The auditor finds no related policies in the corporate policy manual but does discover that the department is following a policy developed by the company's bank. Which of the following would be the most appropriate response from the auditor?

- A. Use the bank's policy as the audit criteria and determine whether formal adoption should be recommended in the engagement final communication.
- B. Withdraw from the audit engagement, because there is nothing to audit due to the lack of a corporate policy.
- C. Perform no further audit work and report the lack of a corporate policy as an audit observation.
- D. Postpone the audit engagement until a corporate policy can be established.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 189

CORRECT ANSWER IS **A** . Its Explanation is

Because there is a formal policy being followed, the engagement can be performed. As part of the engagement, the IAA can determine if the policy that is currently being followed should be formally adopted by the company.

INCORRECT CHOICES EXPLANATION

Explanation for B:

There is no need to withdraw from the engagement. Because there is a policy that is being followed, an engagement can still be performed to determine compliance with that policy.

Explanation for C:

There is no need to postpone the engagement. Because there is a policy that is being followed, an engagement can still be performed to determine compliance with that policy.

Explanation for D:

There is no need to postpone the engagement. Because there is a policy that is being followed, an engagement can still be performed to determine compliance with that policy.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 190

When gathering data, an audit team identified both subjective and objective criteria for measuring audit risk. Which one of the following risk factors is most objective?

- A. Prior audit findings.
- B. Comfort with operating management.
- C. Size of the audit unit.
- D. Changes in staff, systems, or the environment.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 190

CORRECT ANSWER IS **C** . Its Explanation is

Objective means that something is fair, impartial, and unbiased and is not subject to the opinion or judgment of a person. In other words, different people would look at the situation and all come to the same conclusion. The size of the audit unit is a fact, and is not affected by the auditor's impressions and feelings.

INCORRECT CHOICES EXPLANATION

Explanation for A:

Assessment of prior audit findings is dependent on the auditor's impressions and feelings.

Explanation for B:

Comfort with operating management is dependent on the auditor's impressions and feelings.

Explanation for D:

Assessment of changes in staff, systems, or the environment is dependent on the auditor's impressions and feelings.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 191

While conducting a control self-assessment project in an IT division, an internal auditor asks managers to rate the severity of each identified risk and the strength of each related control. Which of the following represents the most significant disadvantage of this exercise?

- A. Management may omit important control weaknesses.
- B. Budget hours expended will exceed any tangible benefits.
- C. The internal audit activity will be viewed as responsible for controls.
- D. Subsequent audits of the division may not be conducted.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 191

CORRECT ANSWER IS **A** . Its Explanation is

A significant risk of asking managers to identify control weaknesses is that management may not identify all of the control weaknesses.

INCORRECT CHOICES EXPLANATION

Explanation for B:

This is not a significant weakness of asking managers to rate the severity of each identified risk and strength of the related controls.

Explanation for C:

This is not a significant weakness of asking managers to rate the severity of each identified risk and strength of the related controls.

Explanation for D:

This is not a significant weakness of asking managers to rate the severity of each identified risk and strength of the related controls.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 192

An auditor has been assigned to analyze the effectiveness of a set of rehabilitation programs. The programs have been in operation for ten years and have not been evaluated. The organization providing the program data asserts that the data is incomplete. The auditor should:

- A. Perform the analysis anyway, assessing the effects of the incomplete data, but disclaim any assertion regarding data reliability.
- B. Postpone the analysis until the data is complete.
- C. Not perform the analysis.
- D. Trace a randomly chosen set of records to source files to assess the accuracy and completeness of the data provided.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 192

CORRECT ANSWER IS **A** . Its Explanation is

The program's effectiveness needs to be assessed, particularly after 10 years. If the auditor disclaims reliability, they will provide an assessment of the effectiveness of the data.

INCORRECT CHOICES EXPLANATION

Explanation for B:

The program's effectiveness needs to be assessed, particularly after 10 years.

Explanation for C:

The program's effectiveness needs to be assessed, particularly after 10 years.

Explanation for D:

The organization has already asserted that the data is incomplete. This step would be redundant.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 193

If a department's operating standards are vague and thus subject to interpretation, an auditor should:

- A. Interpret the standards in their strictest sense because standards are otherwise only minimum measures of acceptance.
- B. Omit any comments on standards and the department's performance in relationship to those standards because such an analysis would be inappropriate.
- C. Seek agreement with the departmental manager as to the criteria needed to measure operating performance.
- D. Determine best practices in the area and use them as the standard.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 193

CORRECT ANSWER IS **C** . Its Explanation is

This is what is required by Standard 2210.A3.

INCORRECT CHOICES EXPLANATION

Explanation for A:

If internal auditors must interpret standards, they should seek agreement with the engagement client.

Explanation for B:

The auditor should first seek to gain an understanding with the departmental manager on the appropriate standards

Explanation for D:

The auditor should seek to understand the operating standards as they are applied to the organization. Also, best practices may produce overly high standards.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 194

Which one of the following forms of audit is most likely to involve a review of an entity's performance of specific activities in comparison to organizational specific objectives?

- A. Information system audit.
- B. Operational audit.
- C. Compliance audit.
- D. Financial audit.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 194

CORRECT ANSWER IS **B** . Its Explanation is

This is an example of an engagement that is a review of an entity's performance of specific activities in comparison to organizational specific objectives.

INCORRECT CHOICES EXPLANATION

Explanation for A:

This is not an example of an engagement that is a review of an entity's performance of specific activities in comparison to organizational specific objectives.

Explanation for C:

This is not an example of an engagement that is a review of an entity's performance of specific activities in comparison to organizational specific objectives.

Explanation for D:

This is not an example of an engagement that is a review of an entity's performance of specific activities in comparison to organizational specific objectives.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 195

Which of the following is true of benchmarking?

- A. It is typically accomplished by comparing an organization's performance with the performance of its closest competitors.
- B. It is accomplished by comparing an organization's performance to that of the best-performing organizations.
- C. It can be performed using either qualitative or quantitative comparisons.
- D. It is normally limited to manufacturing operations and production processes.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 195

CORRECT ANSWER IS **B** . Its Explanation is

Benchmarking involves a comparison against industry leaders or “world-class” operations. Benchmarking either uses industry wide figures (to protect the confidentiality of information provided by participating organizations) or figures from cooperating organizations.

INCORRECT CHOICES EXPLANATION

Explanation for A:

Benchmarking involves a comparison against industry leaders or “world-class” operations. Benchmarking either uses industry wide figures (to protect the confidentiality of information provided by participating organizations) or figures from cooperating organizations.

Explanation for C:

Benchmarking requires measurements, which involve quantitative comparisons.

Explanation for D:

Benchmarking can be applied to all of the functional areas in a company. In fact, because manufacturing often tends to be industry-specific, whereas things like processing an order or paying an invoice are not, there is greater opportunity to improve by learning from global leaders.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 196

Senior representatives for a manufacturing company are reimbursed for 100 percent of their cellular telephone bills. Cellular telephone costs vary significantly from representative to representative and from month to month, complicating the budgeting and forecasting processes. Management has requested that the internal auditors develop a method for controlling these costs. Which of the following would most appropriately be included in the scope of the consulting project?

- A. Control self-assessment involving sales representatives.
- B. Business process review of procurement and payables routines.
- C. Performance measurement and design of the budgeting and forecasting processes.
- D. Benchmarking with other cellular telephone users.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 196

CORRECT ANSWER IS **B** . Its Explanation is

A business process review (BPR) assesses the performance of administrative and financial processes, such as within procurement and payables. BPR considers process effectiveness and efficiency, including the presence of appropriate controls, to mitigate business risk. Because the objective is to control cellular phone costs, BPR is the appropriate tool to use in this area.

INCORRECT CHOICES EXPLANATION

Explanation for A:

Neither control self-assessment nor performance measurement will address management's objective of controlling costs.

Explanation for C:

Neither control self-assessment nor performance measurement will address management's objective of controlling costs.

Explanation for D:

Although benchmarking may have some applicability, it is not the most appropriate tool.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 197

An auditor is reviewing an organization's plan for developing a performance scorecard. Which of the following potential performance measures should the auditor recommend excluding from the performance scorecard?

- A. Product innovation.
- B. Employee development.
- C. Market share.
- D. Customer satisfaction.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 197

CORRECT ANSWER IS **A** . Its Explanation is

Innovations in the production of goods or services do not typically lend themselves to ongoing performance measurement.

INCORRECT CHOICES EXPLANATION

Explanation for B:

Key results in employee development help predict the ability to attract and retain good employees.

Explanation for C:

Key results in market share track changes to the organization's competitive position.

Explanation for D:

Key results in customer satisfaction help predict future sales.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 198

If a department outside the internal audit activity is responsible for reviewing a function or process, the internal auditors should:

- A. Yield the responsibility for assessing the function or process to the other department.
- B. Ignore the work of the other department and proceed with an independent audit.
- C. Reduce the scope of the audit because the work has already been performed by the other department.
- D. Consider the work of the other department when assessing the function or process.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 198

CORRECT ANSWER IS **D** . Its Explanation is

Review and testing of the other department's procedures may reduce necessary audit coverage of the function or process.

INCORRECT CHOICES EXPLANATION

Explanation for A:

The internal audit activity's overall responsibility for assessing the function or process is not affected by the other department's coverage.

Explanation for B:

Concentrating on the function or process might lead to a duplication of efforts.

Explanation for C:

The internal auditor cannot rely on the work of others without verifying the results.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 199

Using the internal audit department to coordinate regulatory examiners' efforts is beneficial to the organization because internal auditor scan:

- A. Supply evidence of adequate compliance testing through internal audit work papers and reports.
- B. Influence the regulatory examiners' interpretation of law to match corporate practice.
- C. Perform fieldwork for the regulatory examiners and thus reduce the amount of time regulatory examiners are onsite.
- D. Recommend changes in scope to limit bias by the regulatory examiners.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 199

CORRECT ANSWER IS **A** . Its Explanation is

Internal auditors have immediate access to work papers and reports, which can supply evidence of compliance testing to the regulatory examiners.

INCORRECT CHOICES EXPLANATION

Explanation for B:

Internal auditors should not attempt to influence regulators' interpretations of law.

Explanation for C:

Internal auditors should not perform fieldwork for regulatory examiners.

Explanation for D:

Internal auditors should not attempt to influence the scope of work of the regulatory examiners. This would be unethical and a violation of The IIA's Code of Ethics.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 200

What is the first step in establishing an effective internal audit performance measurement process?

- A. Define internal audit effectiveness.
- B. Interview key internal and external stakeholders.
- C. Propose specific measures of effectiveness and efficiency.
- D. Align the internal audit process with performance measurement processes used throughout the organization.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 200

CORRECT ANSWER IS **A** . Its Explanation is

The first step is to define internal audit effectiveness, based on the Definition of Internal Auditing, the Code of Ethics, the Standards, existing charters, internal audit deliverables that the activity has agreed to produce, and internal consensus.

INCORRECT CHOICES EXPLANATION

Explanation for B:

See the correct answer for an explanation.

Explanation for C:

See the correct answer for an explanation.

Explanation for D:

See the correct answer for an explanation.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 201

Which of the following audit objectives would be appropriate in an audit of the efficient use of an organization's facilities?

- A. To determine whether rates to lease office space for the organization are reasonable when compared to market lease rates.
- B. To determine whether employees are satisfied with the allocation of office space among departments.
- C. To determine whether the actual capacity is reasonable compared to the needed capacity.
- D. To determine whether facilities are procured competitively.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 201

CORRECT ANSWER IS **C** . Its Explanation is

Measuring actual capacity to needed capacity is a measure of the efficiency of the use of an organization's facilities.

INCORRECT CHOICES EXPLANATION

Explanation for A:

This is not a measure of the efficiency of the use of an organization's facilities.

Explanation for B:

This is not a measure of the efficiency of the use of an organization's facilities.

Explanation for D:

This is not a measure of the efficiency of the use of an organization's facilities.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 202

An internal audit team is performing a due diligence audit to assess plans for a potential merger/acquisition. Which of the following would be the least valid reason for a company to merge with or acquire another company?

- A. To reduce labor costs.
- B. To respond to government policy.
- C. To increase stock prices.
- D. To diversify risk.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 202

CORRECT ANSWER IS **C** . Its Explanation is

Increased stock price is a result of a merger or acquisition that is seen to benefit the company, but it is not a primary reason for doing the acquisition or merger.

INCORRECT CHOICES EXPLANATION

Explanation for A:

Gaining economies of scale by reducing labor costs is a primary reason for acquiring or merging with another company.

Explanation for B:

Responding to government policy is a primary reason for mergers and acquisitions.

Explanation for D:

The diversification of risk is a primary reason a company acquires or merges with another company.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 203

Inherent risk and control risk differ from detection risk in that they

- A. Arise from the misapplication of auditing procedures.
- B. Exist independently of the financial statement audit.
- C. Can be changed at the auditor's discretion.
- D. May be assessed in either quantitative or non-quantitative terms.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 203

CORRECT ANSWER IS **B** . Its Explanation is

Inherent risk is the risk that there is an error in the first place. Control risk is the risk that the internal controls will fail to detect the error. Detection risk is the risk that the auditor will not detect the error. The auditor assesses inherent and control risk, but the auditor is notable to do anything to influence (change) these risks. Detection risk is the only risk that can be changed at the auditor's discretion by altering the nature, timing, or extent of the audit procedures.

INCORRECT CHOICES EXPLANATION

Explanation for A:

Misapplication of auditing procedures affects detection risk, but not inherent or control risk.

Explanation for C:

Inherent and control risk cannot be changed at the auditor's discretion.

Explanation for D:

All three types of risk can be assessed either quantitatively or non-quantitatively.

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 204

During an audit, information is uncovered that could have a significant impact on the organization's competitiveness. According to IIA guidance, when is it appropriate for the internal auditor to communicate this information to management?

- A. After the auditor has decided that the information is substantial and credible.
- B. After the auditor has formulated recommendations.
- C. As soon as the auditor has determined that communicating the information is not a violation of the organization's code of conduct.
- D. Immediately, because of the sensitivity of the information.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 204

CORRECT ANSWER IS **A** . Its Explanation is

Even when information would have a significant impact on the organization's competitiveness, the IAA should determine that the information is substantial and credible before communicating it to management.

INCORRECT CHOICES EXPLANATION

Explanation for B:

The auditor does not need to wait until they have formed recommendations to communicate information that could have as significant impact on the organization's competitiveness to management.

Explanation for C:

Before communicating the information to management, the IAA should determine that the information is credible and material.

Explanation for D:

Section A – Managing the Internal Audit Activity

MULTIPLE CHOICE QUESTION NO. 205

Who has primary responsibility for providing information to the audit committee on the professional and organizational benefits of coordinating internal audit assurance and consulting activities with other assurance and consulting activities?

- A. The CEO.
- B. The external auditor.
- C. The CAE.
- D. Each assurance and consulting function.

Section A – Managing the Internal Audit Activity

ANSWER TO QUESTION NO. 205

CORRECT ANSWER IS **C** . Its Explanation is

The CAE should provide the audit committee with information on the coordination with and oversight of other control and monitoring functions.

INCORRECT CHOICES EXPLANATION

Explanation for A:

The CEO would not normally be responsible for planning, work, and coordination related to internal audit assurance and consulting engagements or coordination with other assurance and consulting activities.

Explanation for B:

The responsibility for ensuring that the internal audit activity's professional and organizational responsibilities maximize the benefits that can be achieved from coordination with other assurance consulting activities lies with the CAE, according to Standard 2050. Comments on this should be reported by the CAE to the audit committee.

Explanation for D:

Not all other assurance and consulting activities are organizationally responsible to the audit committee for their work, and they may not have the opportunity to report information directly to the audit committee.

SECTION B - PLANNING THE ENGAGEMENT



This section has weightage of 20% in exams and contains the 151 Multiple Choice Questions (MCQs).

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 1

The auditor determines that a major user application is implemented on a spreadsheet. The spreadsheet takes input regarding projected freight deliveries from the mainframe computer and develops an optimal freight dispatching plan. When first used two years ago, the spreadsheet helped reduce costs dramatically. However, freight costs have been increasing and no one, other than the developer, has reviewed the spreadsheet. The freight dispatching algorithm is complicated, but the auditor has researched the area and understands the algorithm and its correct computation. The auditor wishes to gain assurance on whether the spreadsheet has properly implemented the freight dispatching algorithm. Which of the following audit procedures would accomplish the task?

- I. Develop an independent spreadsheet and run test data through it and through the user's spreadsheet. Compare the results.
 - II. Use a product to print out the logic of the user spreadsheet. Examine the logic to determine if it has been correctly incorporated into the spreadsheet.
 - III. Develop a set of test data and manually calculate the expected results. Run the test data through the user application.
- A. I and III.
 - B. II only.
 - C. I only.
 - D. I, II, and III.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 1

CORRECT ANSWER IS **D** . Its Explanation is

All three procedures should accomplish the task, although, procedure I is probably the most preferable of the three. The advantage of procedure is that it is a parallel simulation model, and as such, it can emulate routine processing.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

All three procedures should accomplish the task.

Explanation for Choice B:

All three procedures should accomplish the task.

Explanation for Choice C:

All three procedures should accomplish the task.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 2

A transportation department maintains its vehicle inventory and maintenance records in a database. Which of the following audit procedures is most appropriate for evaluating the accuracy of the database information?

- A. Verify a sample of the records extracted from the database with supporting documentation.
- B. Submit batches of test transactions through the current system and verify with expected results.
- C. Simulate normal processing by using test programs.
- D. Use program tracing to show how, and in what sequence, program instructions are processed in the system.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 2

CORRECT ANSWER IS **A** . Its Explanation is

Verifying is the most often used technique in testing the accuracy of information maintained by a system, whether manual or automated.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Testing the program will not test the accuracy of data in the database.

Explanation for Choice C:

Simulating normal processing would test the program but not the accuracy of data.

Explanation for Choice D:

Tracing would require that additional coding be inserted into the database system programs.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 3

While planning an audit, an internal auditor establishes audit objectives to describe what is to be accomplished. Which of the following is a key issue to consider in developing audit objectives?

- A. The recipients of the audit report.
- B. The auditee's objectives and control structure.
- C. The qualifications of the audit staff selected for the engagement.
- D. Recommendations of the auditee's employees.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 3

CORRECT ANSWER IS **B** . Its Explanation is

The auditee's objectives and control structure are key issues to consider in developing audit objectives.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The recipients of the audit report are not key issues to consider in developing audit objectives.

Explanation for Choice C:

The selection of audit staff members can only be done after the audit objectives have been developed.

Explanation for Choice D:

Recommendations of the auditee's employees are not key issues to consider in developing audit objectives.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 4

Management asserted that the performance standards the internal auditors used to evaluate operating performance were inappropriate. Written performance standards established by management were vague and had to be interpreted by the internal auditors. In such cases, internal auditors should

- A. Incorporate management's objections in the final engagement communication.
- B. Assure themselves that their interpretations are reasonable.
- C. Assure themselves that their interpretations are consistent with industry practices.
- D. Establish agreement with engagement clients as to the standards needed to measure performance.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 4

CORRECT ANSWER IS **D** . Its Explanation is

Internal auditors should evaluate established operating targets and expectations and determine whether those operating standards are acceptable and are being met. When such management targets and criteria are vague, authoritative interpretations should be sought. If internal auditors are required to interpret or select operating standards, they should seek agreement with engagement clients as to the criteria needed to measure operating performance.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

It would not be sufficient to incorporate management's objections in the final engagement communication.

Explanation for Choice B:

The internal auditors would work with management in order to develop standards needed to measure performance.

Explanation for Choice C:

The internal auditor's interpretations might not be viable.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 5

In an examination of receiving operations for a manufacturer of small appliances, an auditor will be most concerned with the risk that the function has

- A. Paid inflated prices for goods from related parties.
- B. Received goods that were not ordered.
- C. Accepted goods in excess of current needs.
- D. Failed to detect the receipt of substandard goods.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 5

CORRECT ANSWER IS **D** . Its Explanation is

Inspection of goods by receiving inspectors is essential to prompt detection and reporting of all materials received that fail to meet specifications.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Inappropriate purchasing is involved here, and the risk is associated with non-economical buying practices and conflicts of interest.

Explanation for Choice B:

This is a significant receiving risk, but returns to vendors are possible since no contract exists for goods that were not ordered. The lack of an order can be detected promptly in either receiving (matching purchase order with the goods received) or in accounting (matching invoice with requisition, receiving report, and purchase order). There is a lesser risk of loss than with undetected substandard materials received.

Explanation for Choice C:

Excessive acquisitions are a purchasing function risk, and not a receiving department risk.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 6

An internal auditor is assigned to perform an engagement to evaluate the organization's insurance program, including the appropriateness of the approach to minimizing risks. The organization self-insures against large casualty losses and health benefits provided for all its employees. It is a large national entity with over 15,000 employees located in various parts of the country. It uses an outside claims processor to administer its health care program. The organization's medical costs have been rising by approximately 8% per year for the past five years, and management is concerned with controlling these costs. The internal auditor needs to determine the scope of the proposed evaluation of insurance coverage. Which of the following statements are true regarding the potential scope of the engagement?

- I. The internal audit activity should concentrate on processing that which occurs within the organization and not on evaluating the correctness of transactions processing by the health care processor.
 - II. The internal auditor should interview management prior to beginning the engagement to understand (1) its concerns and (2) the underlying assumptions made and rationale used when making the self-insurance decision.
 - III. The internal auditor should consider engaging an actuarial consultant to better understand the risks involved in order to help determine the scope of the engagement.
- A. II and III.
 - B. I only.
 - C. I and II.
 - D. II only.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 6

CORRECT ANSWER IS **A** . Its Explanation is

Statements II & III are correct. The internal auditor should interview management prior to the beginning of the engagement and should consider engaging an actuarial consultant.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

The internal auditor needs to explain the increase in costs. In order to explain these increases it would be necessary to evaluate the correctness of transactions being processed by the healthcare processor. The internal auditor should also interview management prior to the beginning of the engagement and should consider engaging an actuarial consultant.

Explanation for Choice C:

In order to get a clear understanding of the reasons behind the cost increases it would be necessary to evaluate the correctness of transactions being processed by the health-care processor. The internal auditor should interview management prior to the beginning of the engagement and should consider engaging an actuarial consultant.

Explanation for Choice D:

The internal auditor should interview management prior to the beginning of the engagement and should consider engaging an actuarial consultant.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 7

In planning an engagement, the internal auditor should establish objectives and procedures to address the risk associated with the activity. Risk is defined as

- A. The possibility that the balance or class of transactions and related assertions contains misstatements that could be material to the financial statements.
- B. The failure to accomplish established objectives and goals for operations or programs.
- C. The uncertainty of the occurrence of an event that could affect the achievement of objectives.
- D. The failure to adhere to organizational policies, plans, and procedures or to comply with relevant laws and regulations.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 7

CORRECT ANSWER IS **C** . Its Explanation is

Risk is the uncertainty of the occurrence of an event that could affect the achievement of objectives. Risk is measured in terms of impact (monetary) and likelihood (probability).

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Risk to an organization is the probability that some future event or action could adversely impact the organization. Misstatements that could be material to the financials have to do with audit risk.

Explanation for Choice B:

The failure to accomplish established objectives and goals is a risk factor that needs to be mitigated.

Explanation for Choice D:

The failure to adhere to organizational policies, plans, and procedures or to comply with relevant laws and regulations are risk factors that need to be mitigated.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 8

A company maintains production data on personal computers, connected by a local area network (LAN), and uses the data to generate automatic purchases via electronic data interchange. Purchases are made from authorized vendors based on production plans for the next month and on an authorized materials requirements plan (MRP) which identifies the parts needed for each unit of production.

The production line has experienced shutdowns because needed production parts were not on hand. Which of the following audit procedures would best identify the cause of the parts shortages?

- A. Select a random sample of parts on hand per the personal computer databases and compare with actual parts on hand.
- B. Use generalized audit software to develop a complete list of the parts shortages that caused each of the production shutdowns, and analyze this data.
- C. Select a random sample of production information for selected days and trace input into the production database maintained on the LAN.
- D. Determine if access controls are sufficient to restrict the input of incorrect data into the production database.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 8

CORRECT ANSWER IS **B** . Its Explanation is

This procedure would establish the cause of the problem.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

This would provide useful information, but it is not as comprehensive as the correct answer. Further, the correct answer provides more information on the cause.

Explanation for Choice C:

This tests only one source of the data inaccuracy, that is, the input of production data; other sources of potential error are ignored.

Explanation for Choice D:

Access controls are tangential to the issue. Authorized, but incorrect data, could also be the problem.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 9

An engagement objective is to verify that the correct goods or services are received on time, at the right price, and in the right quantity. Based on this objective, the function to be reviewed is the

- A. Manufacturing department.
- B. Purchasing department.
- C. Payroll department.
- D. Receiving department.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 9

CORRECT ANSWER IS **B** . Its Explanation is

The function of the purchasing department is to make sure that goods or services are received on time, at the right price, and in the right quantity.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The manufacturing department would not verify the price. The cost of materials is transferred at standard cost.

Explanation for Choice C:

The payroll department is not concerned with the receipt or transfer of goods.

Explanation for Choice D:

The receiving department would verify the quantity and quality of goods received, but not the price.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 10

Which of the following procedures would provide the most relevant evidence to determine the adequacy of the allowance for doubtful accounts receivable?

- A. Confirmation of the receivables.
- B. Analyze the allowance through an aging of receivables and an analysis of current economic data.
- C. Analysis of the following month's payments on the accounts receivable balances outstanding.
- D. Test the controls over the write-off of accounts receivable to ensure that management approves all write-offs.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 10

CORRECT ANSWER IS **B** . Its Explanation is

Aging of receivables lends direct, relevant evidence regarding the valuation of receivables and thus the allowance account.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Although some valuation information is implied from the confirmation, aging is more relevant and persuasive.

Explanation for Choice C:

One month's receipts is too little information on which to base the collectability of accounts.

Explanation for Choice D:

Controls over write-offs is not relevant to the account's valuation, but to the authorization of the write-off.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 11

Which of the following procedures provides the most relevant information to determine the adequacy of the allowance for doubtful accounts receivable?

- A. Analyze the following month's payments on the accounts receivable balances outstanding.
- B. Confirm the receivables.
- C. Test the controls over the write-off of accounts receivable to ensure that management approves all write-offs.
- D. Analyze the allowance through an aging of receivables and an analysis of current economic data.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 11

CORRECT ANSWER IS **D** . Its Explanation is

The best method to test the adequacy of the receivable reserve account is through aging of receivables. Analyzing current economic data should also be done since collectability changes with economic conditions.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Analyzing the potential collectability of the receivables provides information about future payments, but it does not provide information on whether the valuation of the reserve account is adequate.

Explanation for Choice B:

Confirming receivables will only state whether the receivable exist, not determine the adequacy of the reserve account.

Explanation for Choice C:

The testing of controls over the write-off of receivables does not provide any useful information on whether the valuation of the reserve account is adequate.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 12

During which phase of the engagement does the internal auditor identify the objectives and related controls of the activity being examined?

- A. Staff selection.
- B. Preliminary survey.
- C. Final communication of results.
- D. Work program preparation.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 12

CORRECT ANSWER IS **B** . Its Explanation is

A preliminary survey should be conducted to become familiar with the engagement client's activities, risks, and controls to identify areas for engagement emphasis, and to invite comments and suggestions from engagement clients (PA 2210.A1-1). Thus, the objectives and related controls of the activity being examined would be conducted during the preliminary survey.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Staff selection is the process of deciding which internal auditors are going to work on the audit.

Explanation for Choice C:

Communicating the final results of the engagement comes after the engagement has been completed.

Explanation for Choice D:

The engagement work program comes after the preliminary survey.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 13

The internal auditor of a construction enterprise that builds foundations for bridges and large buildings performed a review of the expense accounts for equipment (augers) used to drill holes in rocks to set the foundation for the buildings. During the review, the internal auditor noted that the expenses related to some of the auger accounts had increased dramatically during the year. The internal auditor inquired of the construction manager who offered the explanation that the augers last 2 to 3 years and are expensed when purchased. Thus, the internal auditor should see a decrease in the expense accounts for these augers in the next year but would expect an increase in the expenses of other augers. The internal auditor also found out that the construction manager is responsible for the inventorying and receiving of the augers and is a part owner of a business that supplies augers to the organization. The supplier was approved by the president to improve the quality of equipment.

Which of the following procedures would be the least appropriate engagement procedure to address these analytical observations?

- A. Develop a comparative analysis of auger expense over the past few years to determine if the relationship held in previous years.
- B. Note the explanation in the working papers for investigation during the next engagement and perform no further work at this time.
- C. Arrange to take an inventory of augers to determine if the augers purchased this year were on hand and would be available for use in the next 2 years.
- D. Take a sample of debits to the auger expense account and trace to independent shipping documents and to invoices for the augers.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 13

CORRECT ANSWER IS **B** . Its Explanation is

Just noting an explanation in the working papers would be the least appropriate engagement procedure. The construction manager's obvious conflict of interest could be a motive for fraud. Thus, additional work should be done.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Comparative analysis is an effective method of establishing whether the manager's explanation is reasonable.

Explanation for Choice C:

Taking an inventory count is a good method of verifying the existence of the augers.

Explanation for Choice D:

This is a good method of testing whether the augers were actually received.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 14

An internal auditor has set an engagement objective of determining whether mailroom staff is fully used. Which of the following engagement techniques will best meet this objective?

- A. Observation.
- B. Inspection of documents.
- C. Inquiry.
- D. Analytical review.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 14

CORRECT ANSWER IS **A** . Its Explanation is

Observation will be the best method to help the internal auditor determine whether mailroom staff is fully used. Just by observing the mailroom operations at various times of the day the internal auditor should be able to get of better understanding whether the mailroom staff is being used effectively.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Inspection of documents will do little to help the internal auditor determine whether mailroom staff is fully used.

Explanation for Choice C:

Inquiry will do little to help the internal auditor determine whether mailroom staff is fully used.

Explanation for Choice D:

Analytical review will do little to help the internal auditor determine whether mailroom staff is fully used.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 15

The auditor finds a situation where one person has the ability to collect receivables, make deposits, issue credit memos, and record receipt of payments. The auditor suspects the individual may be stealing from cash receipts. Which of the following audit procedures would be most effective in discovering fraud in this scenario?

- A. Send positive confirmations to a random selection of customers.
- B. Send negative confirmations to all outstanding accounts receivable customers.
- C. Take a sample of bank deposits and trace the detail in each bank deposit back to the corresponding entry in the cash receipts journal.
- D. Perform a detailed review of debits to customer discounts, sales returns, or other debit accounts, excluding cash posted to the cash receipts journal.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 15

CORRECT ANSWER IS **D** . Its Explanation is

This is the most effective procedure because it investigates the mechanism that the suspected person would have to use to cover up the scheme and not have customers complaining about their account balances.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Since the suspected person has complete access to the recording mechanism, he or she could pocket the cash and effectively write-off the account by debiting the discounts or returns account. The confirmation will not provide evidence on the problem since the customer's account balance will be correctly stated.

Explanation for Choice B:

Since the suspected person has complete access to the recording mechanism, he or she could pocket the cash and effectively write-off the account by debiting the discounts or returns account. The confirmation will not provide evidence on the problem since the customer's account balance will be correctly stated.

Explanation for Choice C:

This procedure would only provide evidence that all items deposited were represented by bona fide credits to cash receipts. The auditor's concern is the other direction, that is, all items where cash is received are recorded and deposited.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 16

The auditor finds a situation where one person has the ability to collect receivables, make deposits, issue credit memos, and record receipt of payments. The auditor suspects the individual may be stealing from cash receipts. Which of the following audit procedures would be most effective in discovering fraud in this scenario?

- A. Send positive confirmations to a random selection of customers.
- B. Send negative confirmations to all outstanding accounts receivable customers.
- C. Take a sample of bank deposits and trace the detail in each bank deposit back to the corresponding entry in the cash receipts journal.
- D. Perform a detailed review of debits to customer discounts, sales returns, or other debit accounts, excluding cash posted to the cash receipts journal.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 16

CORRECT ANSWER IS **A** . Its Explanation is

This would be the least effective procedure because it only analyzes overtime costs. It does not relate the costs to underlying production data.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Interviews with employees would be effective in understanding morale issues as well as gathering suggestions for improvement.

Explanation for Choice C:

This procedure would be effective in determining whether productivity decreases during overtime periods.

Explanation for Choice D:

Best practices, where available, can be useful in providing insight on potential areas of improvement.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 17

In the annual review of the data center of a nationwide mortgage servicing company, the internal audit manager was concerned about the data center not having an adequate contingency plan.

The audit manager was especially concerned because the data center was located close to a river that occasionally flooded and in the vicinity of a major railroad and a major highway.

Even though floodwaters might not reach the data center, being located adjacent to a river is associated with the risk that in the event of a significant flood

- A. Employees might be unable to report for work.
- B. Expensive equipment might need to be replaced.
- C. Customers might refuse to do business with the company.
- D. Many customers might fail to make timely payments.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 17

CORRECT ANSWER IS **A** . Its Explanation is

If the area floods, some employees may be unable to report for work due to flooded roads or to the demands on them to care for injured loved ones or their own damaged property.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

As long as floodwaters do not reach the data center, there should be no special threat to the equipment.

Explanation for Choice C:

Customers are unlikely to refuse to do business with the company because mortgagee customers generally do not have control over how mortgage servicing rights are assigned.

Explanation for Choice D:

Because the company is a nationwide mortgage servicing company, most payments will be coming from places other than the immediate vicinity, which would most likely not be affected by a flood in the local area. Mail containing payments might be delayed, but large groups of customers are unlikely to fail to make payments.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 18

One of the primary roles of an engagement work program is to

- A. Document an internal auditor's evaluations of controls.
- B. Provide for a standardized approach to the engagement.
- C. Assess the risks associated with the activity under review.
- D. Serve as a tool for planning and conducting engagement work.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 18

CORRECT ANSWER IS **D** . Its Explanation is

Internal auditors should develop work programs that achieve the engagement objectives. An engagement work program collects, analyze, interpret, and documents information.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The working papers will contain an evaluation of controls.

Explanation for Choice B:

The engagement work program will probably not be standardized, and will probably change from year-to-year given the changing conditions of the company.

Explanation for Choice C:

Risk assessment is done in the planning phase of the engagement, which helps to identify objectives. This has to be done before the work program can be developed.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 19

The internal auditor wishes to test the assertion that all claims paid by a medical insurer 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 engagement procedure is to select a sample of

- A. All policyholders and examine all claims for the sampled items during the year to determine whether they were handled properly.
- B. Claims denied and determine that all claims denied were appropriate. The claims denied file is much smaller and the internal auditor can obtain greater coverage with the sample size.
- C. Claims filed and trace to documentary information about authorization and other supporting documentation.
- D. Paid claims from the claims (cash) disbursement file and trace to documentary information about authorization and other supporting documentation.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 19

CORRECT ANSWER IS **D** . Its Explanation is

This would be the most useful procedure in determining whether paid claims were properly authorized and were properly supported.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Sampling all policyholders and examining all claims would not be the most appropriate or efficient engagement procedure.

Explanation for Choice B:

Claims denied would not provide the most useful information.

Explanation for Choice C:

The procedure would not provide information on the overall processing of claims. In addition, the sample population should be not claims filed, but claims paid.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 20

Documentation required to plan an internal auditing engagement should include information that

- A. Intended engagement observations have been clearly identified.
- B. Internal audit activity resources are efficiently and effectively employed.
- C. Resources needed to complete the engagement were considered.
- D. Planned engagement work will be completed on a timely basis.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 20

CORRECT ANSWER IS **C** . Its Explanation is

In planning the engagement, internal auditor should consider the resources needed to complete the engagement.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Intended engagement observations that should be identified would be determined by the scope of work to be performed.

Explanation for Choice B:

IAA resources are efficiently and effectively employed can only be measured at the end of the engagement.

Explanation for Choice D:

Completing the engagement on time will not be known when planning the engagement.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 21

In engagement planning, internal auditors should review all relevant information. Which of the following sources of information would most likely help identify suspected violations of environmental regulations?

- A. Review of correspondence the entity has conducted with governmental agencies.
- B. Discussions with operating executives.
- C. Review of trade publications.
- D. Discussions conducted with the external auditors in coordinating engagement efforts.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 21

CORRECT ANSWER IS **A** . Its Explanation is

Review of correspondence with regulatory agencies would be the best source of information.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Operating managers would not be the best source since they likely will be biased.

Explanation for Choice C:

Trade publications will not likely offer any useful information.

Explanation for Choice D:

It is unlikely the external auditors would have the needed information.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 22

An electric utility company records capital and maintenance expenditures through the use of a computerized project tracking system. Labor, material, and overhead are charged to the applicable project number. Monthly reports are produced which detail individual charges to each project, and expenditure totals are provided for the current month, fiscal year, and project life to date.

Monthly project reports compare actual costs to original budget estimates and compute variances. Project variations greater than 10 percent of budget require subsequent explanation and approval by the supervisor.

Which of the following audit test(s) would the internal auditor use to determine whether the required procedure is being followed?

- I. Select a sample of over-budget explanations and test for subsequent approvals.
- II. Trace over-budget explanations to supporting monthly project reports.
- III. Use audit software to re-compute monthly project report variances and totals.
- IV. Compare a sample of project variances to documented approvals and explanations.

- A. III and IV.
- B. I, II and III.
- C. I and II only.
- D. IV only.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 22

CORRECT ANSWER IS **D** . Its Explanation is

This is the only test that selects from the appropriate population (project variances) and verifies that needed approvals and explanations are given.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Re-computing totals does not test the procedure described.

Explanation for Choice B:

Re-computing totals does not test the procedure described.

Explanation for Choice C:

Tracing to the monthly report does not ensure that all variances have explanations.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 23

The internal auditors for a large manufacturing company have been requested to conduct a review of the company's production planning system. Production data, collected on personal computers (PC's) connected by a local area network (LAN), are used for generating automatic purchases via electronic data interchange. Purchases are made from authorized vendors based on production plans for the next month and on an authorized materials requirement plan (MRP) which identifies the parts needed per unit of production.

The auditor wants to determine if purchasing requirements have been updated for changes in production techniques. Which of the following audit procedures would be most effective in addressing the auditor's objective?

- A. Take a sample of production estimates and MRP's for several periods and trace them into the system to determine that input is accurate.
- B. Use generalized audit software to develop a report of excess inventory. Compare the inventory with current production volume.
- C. Develop test data to input into the LAN and compare purchase orders generated from test data with purchase orders generated from production data.
- D. Recalculate parts needed based on current production estimates and on the MRP for the revised production techniques. Compare these needs with purchase orders generated from the system for the same period.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 23

CORRECT ANSWER IS **D** . Its Explanation is

This is the most appropriate procedure because: (a) the auditor has already determined that there is a concern; and (b) this procedure results in a direct comparison of current part requirements with purchase orders being generated. Differences can be identified and corrective action taken.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

This procedure provides evidence on the input of data into the system, but does not provide evidence on whether changes in the production process have been implemented.

Explanation for Choice B:

Generalized audit software is a good method to identify an inventory problem. However, the excess inventory may not be the result of a revised production technique. The correct answer more directly addresses the audit concern.

Explanation for Choice C:

This procedure provides evidence that all items entered are processed. Comparison with currently generated purchase orders does not provide evidence on whether the correct parts are being ordered.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 24

Which of the following procedures would an auditor least likely perform in planning a financial statement audit.

- A. Coordinating the assistance of entity personnel in data preparation.
- B. Reading the current year's interim financial statements.
- C. Discussing matters that may affect the audit with firm personnel responsible for non-audit services to the entity.
- D. Selecting a sample of vendors' invoices for comparison with receiving reports.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 24

CORRECT ANSWER IS **D** . Its Explanation is

Selecting a sample of vendor's invoices for comparison is a substantive test that would be conducted during the fieldwork stage.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Coordinating the assistance of entity personnel in data preparation is an example of a planning procedure.

Explanation for Choice B:

Reading the current year's interim financial statements is an example of a planning procedure.

Explanation for Choice C:

Discussing matters that may affect the audit with firm personnel responsible for non-audit services is an example of a planning procedure.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 25

Inventory levels for a packing facility are controlled by the use of just-in-time techniques. If the auditor's objective is to evaluate ordering and stocking standards, which of the following procedures would be relevant?

- I. Using audit software to compute the number of shipping crates used per day.
- II. Reviewing shipping records for product quantity and dates.
- III. Comparing actual stocking levels to industry averages.
- IV. Reviewing sales records for defective returns.

- A. I and II.
- B. III only.
- C. II and III.
- D. I and IV.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 25

CORRECT ANSWER IS **A** . Its Explanation is

Shipping requirements and timing would be recomputed to verify the just-in-time standards utilized for quality control.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

There are no industry averages for just-in-time (zero balance)

Explanation for Choice C:

Actual stocking levels would meet the objective of meeting just-in-time standards, not establishing them.

Explanation for Choice D:

Sales adjustments would meet product quality objectives, not stocking standards.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 126

A small city managed its own pension fund. According to the city charter, investments could be made only in bonds, money market funds, or high-quality stocks. The internal auditor has already verified the existence of the pension fund's assets. The fund balance was not very large and was managed by the city treasurer. The internal auditor decided to estimate income from investments of the fund by multiplying the average fund balance by a weighted-average rate based on the current portfolio mix. Upon doing so, the internal auditor found that recorded return was substantially less than was expected. The internal auditor's next procedure should be to

- A. Inquire of the treasurer as to the reason that income appears to be less than expected.
- B. Prepare a more detailed estimate of income by consulting a dividend and reporting service that lists the interest or dividends paid on specific stocks and bonds.
- C. Inform management and the board that fraud is suspected and suggest that legal counsel be called in to complete the investigation.
- D. Select a sample of entries to the pension fund income account and trace to the cash journal to determine if cash was received.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 126

CORRECT ANSWER IS **B** . Its Explanation is

The internal auditor's next procedure would be to prepare more analytical procedures. The intent is to evaluate the results in order to explain the differences between the expectations and the results. When analytical auditing procedures identify unexpected results or relationships, internal auditors should examine and evaluate such or relationships. The examination and evaluation of unexpected results or relationships from applying analytical auditing procedures should include inquiries of management and the application of other engagement procedures until internal auditors are satisfied that the results or relationships are sufficiently explained.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The next course of action for the internal auditor is to do more work, i.e., income estimating. Only then would the internal auditor discuss the matter with the treasurer.

Explanation for Choice C:

At this point the internal auditor does not have enough sufficient information to conclude that fraud has occurred.

Explanation for Choice D:

This procedure would only provide information about the amount of cash received from the investments. This would not explain the differences between the expectations and the results.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 127

A company maintains production data on personal computers, connected by a local area network (LAN), and uses the data to generate automatic purchases via electronic data interchange.

Purchases are made from authorized vendors based on production plans for the next month and on an authorized materials requirements plan (MRP) which identifies the parts needed for each unit of production.

Which of the following audit procedures would be most effective in determining if purchasing requirements have been updated for changes in production techniques?

- A. Select a sample of production estimates and MRPs for several periods and trace them into the system to determine that input is accurate.
- B. Develop test data to input into the LAN and compare purchase orders generated from test data with purchase orders generated from production data.
- C. Recalculate parts needed based on current production estimates and the MRP for the revised production techniques. Compare these needs with purchase orders generated from the system for the same period.
- D. Use generalized audit software to develop a report of excess inventory. Compare the inventory with current production volume.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 127

CORRECT ANSWER IS **C** . Its Explanation is

This is the most appropriate procedure because: (a) the auditor has already determined that there is a concern; and (b) this procedure results in a direct comparison of current part requirements with purchase orders being generated. Differences can be identified and corrective action taken.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

This procedure provides evidence on the input of data into the system, but does not provide evidence on whether changes in the production process have been implemented.

Explanation for Choice B:

This procedure provides evidence that all items entered are processed. Comparison with currently generated purchase orders does not provide evidence on whether the correct parts are being ordered.

Explanation for Choice D:

Generalized audit software is a good method to identify an inventory problem. However, the excess inventory may not be the result of a revised production technique. The correct answer more directly addresses the audit concern.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 128

One of the audit objectives for a manufacturing company is to verify that all rework is reviewed by the production engineer. Which of the following audit procedures would provide the best evidence for meeting this objective?

- A. Trace a sample of entries in the review log to rework orders.
- B. Trace a sample of entries in the rework log to remedial action taken.
- C. Trace a sample of rework orders to entries in the review log.
- D. Trace a sample of rework orders to entries in the rework log.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 128

CORRECT ANSWER IS **C** . Its Explanation is

The audit objective is to verify that all rework is reviewed by the production engineer. The best evidence to meet this objective is to trace a sample of rework orders to entries in the review log.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The direction of this procedure is wrong. It would not detect un-reviewed work orders.

Explanation for Choice B:

Tracing a sample of entries in the rework log to remedial action taken considers only the rework jobs that require remedial action. Not all of the rework orders will require remedial action.

Explanation for Choice D:

This procedure would be useful for verifying that all rework is recorded in the rework log. But, it would not provide any evidence that the rework orders were reviewed.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 129

An internal auditor observes that controls over the perpetual inventory system are weak. An appropriate engagement response is to

- A. Increase the testing of the inventory controls.
- B. Recommend that a physical inventory count be scheduled.
- C. Apply gross profit analyses by product lines and compare the results with prior-years' information for reasonableness.
- D. Perform turnover ratio tests.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 129

CORRECT ANSWER IS **B** . Its Explanation is

The most appropriate response would be to recommend a physical inventory count. Observing a physical inventory count would be the most persuasive form of information.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

If the internal auditor observes that controls are weak then increasing the testing of controls would probably be inefficient.

Explanation for Choice C:

Applying gross profit analyses would not be sufficient.

Explanation for Choice D:

Performing turnover ratio tests would not provide sufficient information.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 130

An auditor plans to evaluate the adequacy of a company's insurance coverage. What is the most likely source of information for a detailed schedule of insurance policies in force?

- A. The files containing insurance policies with various carriers.
- B. The current fiscal year's budget for prepaid insurance together with the beginning balance of the account.
- C. Original journal entries found in the cash disbursements journal and supported by canceled checks.
- D. The corporate charter prescribing the insurance staff's objectives, authority, and responsibilities.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 130

CORRECT ANSWER IS **A** . Its Explanation is

The files containing the insurance policies would be the source of information regarding type of coverage, terms, premiums, and possible restrictive endorsements.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

The budget for the current fiscal year is but a plan, which may or may not be achieved or fully meet the optimum desired by the insurance staff. Furthermore, some premiums paid in prior periods would have carried over into this period.

Explanation for Choice C:

It would be impractical to scan journal entries in order to construct a current list of insurance policies. Furthermore, some premiums paid in prior periods carry over into this and possibly future periods while premiums paid in this period probably extend coverage into future periods.

Explanation for Choice D:

The charter granted by management would be broad and general in scope, not detailed and procedural. This would be delegated to the insurance staff.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 131

As a means of controlling projects and avoiding time-budget overruns, decisions to revise time budgets for an audit should normally be made

- A. When a significant deficiency has been substantiated.
- B. When inexperienced audit staff members are assigned to an audit.
- C. Immediately after completing the preliminary survey.
- D. Immediately after expanding tests to establish reliability of findings.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 131

CORRECT ANSWER IS **C** . Its Explanation is

Time budgets should be appraised for revision after the preliminary survey and preparation of the audit program.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

When a deficiency has been substantiated, no further audit work is required.

Explanation for Choice B:

The assignment of inexperienced staff should have no effect on the time budget.

Explanation for Choice D:

Expanded tests should have no effect on the time budget; the budget would have already been expanded as necessary.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 132

During interviews with the inventory management personnel, an internal auditor learned that salespersons often order inventory for stock without receiving the approval of the vice president of sales. Also, detail testing showed that there are no written approvals on purchase orders for replacement parts. The detail testing is a good example of

- A. Subjective evidence.
- B. Circumstantial evidence.
- C. Indirect evidence.
- D. Corroborative evidence.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 132

CORRECT ANSWER IS **D** . Its Explanation is

Corroborative evidence is evidence that supports other evidence. In this case, the detailed testing provided corroborative evidence.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The detail testing of provided was more than subjective evidence. Subjective evidence is based on opinion. No opinions were given in this situation.

Explanation for Choice B:

Circumstantial evidence is evidence that indicates another event or item occurred or existed. The detailed testing provided more than circumstantial evidence.

Explanation for Choice C:

Detailed testing provides direct evidence that inventory was ordered without the approval of the vice president.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 133

The chief audit executive (CAE) of a multinational organization must form an engagement team to examine a newly acquired subsidiary in another country. Consideration should be given to which of the following factors?

- I. Local customs
- II. Language skills of the internal auditor
- III. Experience of the internal auditor
- IV. Monetary exchange rate

- A. I and II.
- B. I and III.
- C. I, II, and III.
- D. II, III, and IV.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 133

CORRECT ANSWER IS **C** . Its Explanation is

Local customs, language skills of internal auditors, and experience of the internal auditors are all important considerations in selecting the engagement team to examine a newly acquired subsidiary in another country.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The experience of the internal auditor would also be considered an important factor when selecting the team.

Explanation for Choice B:

The language skills of the internal auditor would also be considered an important factor when selecting the team.

Explanation for Choice D:

Local customs would also be considered an important factor when selecting the team, but exchange rate would be irrelevant.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 134

During an engagement relating to purchasing, the internal auditor finds that the largest blanket purchase order is for tires, which are expensed as vehicle maintenance items. The fleet manager requisitions tires against the blanket order for the company's 400-vehicle service fleet based on a visual inspection of the cars and trucks in the parking lot each week. Sometimes the fleet manager picks up the tires but always signs the receiving report for payment. Vehicle service data are entered into a maintenance database by the mechanic after the tires are installed. What is the best course of action for the internal auditor in these circumstances?

- A. Count the number of tires on hand and trace them to the related receiving reports.
- B. Select a judgmental sample of requisitions and verify that each one is signed by the fleet manager.
- C. Compare the number of tires purchased under the blanket purchase order with the number of tires purchased in the prior year for reasonableness.
- D. Determine whether the number of tires purchased can be reconciled to maintenance records.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 134

CORRECT ANSWER IS **D** . Its Explanation is

The best course of action for the internal auditor is to determine whether the number of tires purchased can be reconciled to maintenance records. The fact that the fleet manager requisitions tires and also signs the receiving report provides an opportunity to commit fraud. The internal auditor should try to determine whether fraud has occurred.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

This method would be ineffective in revealing fraud since the fleet manager signs the receiving report.

Explanation for Choice B:

This method would be ineffective in revealing fraud since the fleet manager signs the receiving report.

Explanation for Choice C:

Comparing tire purchases with prior years would not be effective in revealing fraud since fraud could have been committed in the previous year as well.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 135

Employees using personal computers have been reporting occupational injuries and claiming substantial workers' compensation benefits. The working papers of an engagement performed to determine the extent of the organization's exposure to such personal injury liability should include

- A. Analysis of claims by type of equipment and extent of use by individual employees.
- B. Listings of all personal computers in use and the employees who use them.
- C. Reviews of documentation supporting purchases of personal computers.
- D. Confirmations from insurance carriers as to claims paid under workers' compensation policies in force.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 135

CORRECT ANSWER IS **A** . Its Explanation is

In order to determine the extent of the organization's exposure to personal injury liability an analysis of claims by type of equipment and extent of use by individual employees should be included.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Listing all PCs in use and the employees who use them does not address the risks associated with using the computers.

Explanation for Choice C:

Reviewing documentation supporting purchases of PCs will not address the issue of the organization's exposure to personal injury liability.

Explanation for Choice D:

Confirmations from insurance carriers would only be able to confirm claims paid.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 136

An internal auditor is performing an operational engagement at a division and observes that an unusually large quantity of goods is on hand in the shipping and materials rework areas. The items are labeled as re-ship items. Upon inquiry the internal auditor is told that they are goods that have been returned by customers and have either been repaired and shipped back to the original customer or repaired and shipped out as new products because they are fully warranted.

The internal auditor has not yet performed any detailed engagement work. Based on the information given, the most appropriate action for the internal auditor to take is to

- A. Report the items to divisional management and ask for its explanation before determining whether to include the observations in an engagement communication.
- B. Report the observations but do not perform any additional work without the approval of the chief audit executive because such work is clearly a scope expansion.
- C. Take a sample of the items on hand and compare them with the underlying documents, such as receiving reports and sales orders, to determine how the goods were handled.
- D. Do not report the observations since they are outside the scope of the engagement.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 136

CORRECT ANSWER IS **C** . Its Explanation is

Based on the available information, the most appropriate action for the internal auditor to take is to sample the items on hand and then review the related documents to get a better understanding of the transactions.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The internal auditor needs to gather and corroborate the information before having a discussion with management.

Explanation for Choice B:

Observations should generally not be communicated until the internal auditor has gathered enough corroborating information to determine the nature of the potential problem.

Explanation for Choice D:

Since this is an operational engagement the internal auditor should gather more information about the transactions.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 137

One of the objectives of an inventory system audit is to determine if merchandise levels are replenished on a timely basis. An appropriate audit procedure for this objective would involve detailed testing of the

- A. Edit program that lists all quantities sold.
- B. Edit program that lists batch totals for shipments.
- C. Update program that creates new purchase orders.
- D. Update program that creates new part numbers.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 137

CORRECT ANSWER IS **C** . Its Explanation is

New purchase orders produce evidence that inventory is to be replenished.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Testing an edit program that lists all quantities sold will not determine if merchandise levels are replenished.

Explanation for Choice B:

Testing edit program that lists batch totals for shipments would not determine if merchandise levels are replenished on a timely basis.

Explanation for Choice D:

This audit procedure would indicate activity only for new inventory items, not if merchandise levels are replenished on a timely basis.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 138

During an investigation of unexplained inventory shrinkage, an internal auditor is testing inventory additions as recorded in the perpetual inventory records. Because of internal control weaknesses, the information recorded on receiving reports may not be reliable. Under these circumstances, which of the following documents provides the best information about additions to inventory?

- A. Purchase requisitions.
- B. Vendors' statements.
- C. Vendors' invoices.
- D. Purchase orders.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 138

CORRECT ANSWER IS **C** . Its Explanation is

The information from the vendors' invoices will confirm if the amounts have been properly recorded and added to inventory.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The quantity requested from the purchase requisition will not necessarily be the same as quantity shipped.

Explanation for Choice B:

It is possible that additional inventory was sent and received after the date of the statement.

Explanation for Choice D:

The quantity ordered from the purchase order will not necessarily be the same as quantity shipped.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 139

A large manufacturer has a transportation division that supplies gasoline (petrol) for the organization's vehicles. Gasoline is dispensed by an attendant who records the amount issued on a serially pre-numbered gasoline disbursement form, which is then given to the accounting department for proper recording. When the quantity of gasoline falls to a certain level, the service station attendant prepares a purchase requisition and sends it to the purchasing department where a purchase order is prepared and recorded in a gasoline purchases journal.

Which of the following engagement procedures best determines whether gasoline disbursements are fully recorded?

- A. Select a number of gasoline purchases from the gasoline purchases journal and compare them with their corresponding purchase orders and ascertain that they are serially pre-numbered, are matched with purchase requisitions, and are authorized by someone independent of employees of the service station.
- B. Match the quantity of gasoline disbursed according to disbursement forms with an independent reading of quantity disbursed at the pump.
- C. Compare the gasoline purchase requisitions with the gasoline disbursement records.
- D. Perform analytical procedures comparing this period's gasoline consumption with prior periods.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 139

CORRECT ANSWER IS **B** . Its Explanation is

By matching the quantity of gasoline disbursed according to disbursement forms with an independent reading of quantity disbursed at the pump the internal auditor is in a position to determine whether gasoline disbursements were fully recorded.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

These procedures would not determine whether gasoline disbursements are fully recorded.

Explanation for Choice C:

Comparing gasoline purchase requisitions with disbursement records would not be meaningful. Gasoline may have been requested.

Explanation for Choice D:

Performing analytical procedures comparing this period's consumption with prior periods would not be a meaningful procedure.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 140

Shipments are made from the warehouse based on customer purchase orders. The matched shipping documents and purchase orders are then forwarded to the billing department for sales invoice preparation. The shipping documents are neither accounted for nor pre-numbered. Which of the following substantive tests should be extended as a result of this control weakness?

- A. Select bills of lading from the warehouse and trace the shipments to the related sales invoices.
- B. Trace quantities and prices on the sales invoice to the customer purchase order and test extensions and footings.
- C. Foot the sales register and trace the total to the general ledger.
- D. Trace a sample of purchase orders to the related sales invoices.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 140

CORRECT ANSWER IS **A** . Its Explanation is

Since shipping documents are neither accounted for nor pre-numbered, it is likely that some shipments will leave the warehouse without being billed. Selecting bills of lading from the warehouse and tracing the shipments to the related customer invoices is a test to see whether all shipments are being billed.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Tracing quantities and prices on the sales invoice to the customer purchase order and testing extensions and footings would not test to see whether all shipments are being billed.

Explanation for Choice C:

Footing the sales register and tracing the total to the general ledger would not test to see whether all shipments are being billed.

Explanation for Choice D:

Tracing a sample of purchase orders to the related sales invoices would not test to see whether all shipments are being billed.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 141

If an auditor's preliminary evaluation of internal controls results in an observation that controls may be inadequate, the next step would be to:

- A. Note an exception in the engagement final communication if losses have occurred.
- B. Expand audit work before the preparation of an engagement final communication.
- C. Implement the desired controls.
- D. Prepare a flowchart depicting the internal control system.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 141

CORRECT ANSWER IS **B** . Its Explanation is

If the preliminary evaluation indicates control problems, the auditor usually decides to perform some expanded testing.

INCORRECT CHOICES EXPLANATION

Explanation for A:

The auditor is not ready to make a report until more work has been performed.

Explanation for C:

Auditors do not implement controls; that is a function of management.

Explanation for D:

If a flowchart were necessary, the auditor would have prepared one during the preliminary evaluation.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 142

In which phase(s) of the internal audit engagement can data analytics be used?

- I. Planning the individual engagement.
- II. Testing the effectiveness and efficiency of controls.
- III. Assessing risk to determine which areas of the organization to audit.

A.I only.

B.II only.

C.I and III only.

D.I, II, and III.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 142

CORRECT ANSWER IS **D** . Its Explanation is

Data analytics can be used in all phases of the audit process, although many times it is used for testing the effectiveness and efficiency of controls. Internal audit data analytics can also be used as part of continuous auditing and can be performed throughout the year.

INCORRECT CHOICES EXPLANATION

Explanation for A:

The use of data analytics is not limited to planning individual engagements. Data analytics can be used to test the effectiveness of controls and assess risk to prioritize which areas to audit.

Explanation for B:

The use of data analytics is not limited to testing the effectiveness and efficiency of controls. Data analytics can be used to design scope and plan testing for individual engagements as well as assess risk within the audit universe to prioritize which areas to audit.

Explanation for C:

The use of data analytics is not limited to assessing risk to determine which areas to audit. Data analytics can be used to design scope and plan testing for individual engagements as well as test the effectiveness of controls within an audit. **716**

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 143

Which of the following factors should an internal auditor consider when planning an audit of an activity?

- A. The qualifications of management, the significant risks, and the control system.
- B. The objectives of the activity, the significant risks, and the control system.
- C. The number of employees involved, the control system, and the recommendations of external auditors.
- D. The objectives of the activity, the number of employees involved, and the control system.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 143

CORRECT ANSWER IS **B** . Its Explanation is

These are main factors to take into account when planning an engagement.

INCORRECT CHOICES EXPLANATION

Explanation for A:

The qualifications of management is not a main factor in planning an engagement.

Explanation for C:

The number of employees involved and the recommendations of external auditors are not main factors in planning an engagement.

Explanation for D:

The number of activities is not a main factor in planning an engagement.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 144

A CAE would most likely use risk assessment for audit planning because it provides:

- A. A list of auditable activities in the organization.
- B. A listing of potentially adverse effects on the organization.
- C. The probability that an event or action may adversely affect the organization.
- D. A systematic process for assessing and integrating professional judgment about probable adverse conditions.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 144

CORRECT ANSWER IS **D** . Its Explanation is

This is an appropriate rationale.

INCORRECT CHOICES EXPLANATION

Explanation for A:

This is used in the risk assessment process but is not the rationale for using risk assessment.

Explanation for B:

Such a listing might convince the CAE of the need for risk assessment but is not provided by the process.

Explanation for C:

This is one definition of risk.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 145

The chief audit executive (CAE) for an organization has just completed a risk assessment process, identified the areas with the highest risks, and assigned an engagement priority to each. Which of the following conclusions most logically follow(s) from such a risk assessment?

- I. Items should be quantified as to risk in the rank order of quantifiable monetary exposure to the organization.
- II. The risk priorities should be in order of major control deficiencies.
- III. The risk assessment process, though quantified, is the result of professional judgments about both exposures and probability of occurrences.

- A. I only.
- B. I, II, and III.
- C. II and III only.
- D. III only.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 145

CORRECT ANSWER IS **D** . Its Explanation is

Audit work schedules are based on, among other factors, an assessment of risk and exposure. Prioritizing is needed to make decisions for applying resources. A variety of risk models exist to assist the CAE. Most risk models use risk factors, such as impact, likelihood, materiality, asset liquidity, management competence, quality of and adherence to internal controls, degree of change or stability, timing and results of last engagement, complexity, and employee and government relations (PA 2010-1).

INCORRECT CHOICES EXPLANATION

Explanation for A:

The risk assessment process is based on a number of factors, including professional judgment about exposure and probability of occurrence. Conclusions I & II state specific criteria that may not be consistent with the internal auditor's professional judgment.

Explanation for B:

The risk assessment process is based on a number of factors, including professional judgment about exposure and probability of occurrence. Conclusions I & II state specific criteria that may not be consistent with the internal auditor's professional judgment.

Explanation for C:

The risk assessment process is based on a number of factors, including professional judgment about exposure and probability of occurrence. Conclusions I & II state specific criteria that may not be consistent with the internal auditor's professional judgment.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 146

Which of the following represent(s) appropriate internal audit action in response to the risk assessment process?

- I. The low-risk areas may be delegated to the external auditor, but the high-risk areas should be performed by the internal audit activity.
- II. The high-risk areas should be integrated into an engagement work schedule along with the high-priority requests of senior management and the audit committee.
- III. The risk analysis should be used in determining an annual engagement work schedule; therefore, the risk analysis should be performed only on an annual basis.

- A.II only.
- B.I only.
- C.III only.
- D.I and III only.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 146

CORRECT ANSWER IS **A** . Its Explanation is

Risk assessment is part of the planning process. Higher perceived risk areas are generally given higher priority than lower perceived risk areas. Requests by senior management, the audit committee, and the governing are also considered in establishing engagement work schedule priorities.

INCORRECT CHOICES EXPLANATION

Explanation for B:

Work with the external auditor should be coordinated in order to minimize duplication of work effort.

Explanation for C:

Risk analysis should be performed anytime there is a change in the work environment.

Explanation for D:

Risk analysis should be performed anytime there is a change in the work environment, and work with the external auditor should be coordinated in order to minimize duplication of the work effort.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 147

A bank internal auditor wants to determine whether all loans are supported by sufficient collateral, properly aged regarding current payments, and accurately categorized as current or noncurrent. The best audit procedure to accomplish these objectives would be to:

- A. Select a discovery sample of all loan applications to determine whether each application contains a statement of collateral.
- B. Use generalized audit software to read the total loan file, age the file by last payment due, and extract a statistical sample stratified by the current and aged population. Examine each loan selected for proper collateralization and aging.
- C. Select 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.
- D. Select a sample of payments made on the loan portfolio and trace them to loans to see if the payments are properly applied. For each loan identified, examine the loan application to determine that the loan has proper collateralization.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 147

CORRECT ANSWER IS **B** . Its Explanation is

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 and aged.

INCORRECT CHOICES EXPLANATION

Explanation for A:

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

Explanation for C:

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

Explanation for D:

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

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 148

Writing an engagement work program occurs at which stage of the engagement?

- A. During the planning stage.
- B. Subsequent to evaluating risk management and control systems.
- C. At the end of each engagement when the standard work program should be revised for the next engagement to ensure coverage of noted problem areas.
- D. As the engagement is performed.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 148

CORRECT ANSWER IS **A** . Its Explanation is

Internal auditors write the engagement work program during the planning stage. Internal auditors must develop a plan for each engagement, including the engagement's objectives, scope, timing, and resource allocations (Standard 2200).

INCORRECT CHOICES EXPLANATION

Explanation for B:

The work program must be written in planning stage.

Explanation for C:

It is allowed to revise the work program at the end of the engagement for the next engagement, but the work program must still be written in the planning stage.

Explanation for D:

The work program must be written in the planning stage.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 149

As part of a preliminary survey of the purchasing function, an auditor read the department's policies and procedures manual. The auditor concluded that the manual described the processing steps well and contained an appropriate internal control design. The next engagement objective was to determine the operating effectiveness of internal controls. Which procedure would be most appropriate in meeting this objective?

- A. Prepare a flowchart.
- B. Perform a substantive test.
- C. Prepare a system narrative.
- D. Perform a test of controls.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 149

CORRECT ANSWER IS **D** . Its Explanation is

Tests of controls, also known as compliance tests, help an auditor determine whether controls are being followed and are effective. For instance, a policy may require that all large transactions be approved by a manager. As a test of controls, the auditor may sample large transactions and review whether manager approval was obtained and whether the proposed transaction meets all the criteria that the manager was supposed to verify.

INCORRECT CHOICES EXPLANATION

Explanation for A:

Flowcharts are most appropriate for studying internal control design. The audit objective is whether the controls are in place and effective, which indicates the need for a test of controls.

Explanation for B:

Substantive tests are tests to determine whether an objective has been achieved and do not necessarily test internal controls.

Explanation for C:

System narratives are most appropriate for studying internal control design. The audit objective is whether the controls are in place and effective, which indicates the need for a test of controls.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 150

Audit engagement programs testing internal controls should:

- A. Be generalized to fit all situations without regard to departmental lines.
- B. Reduce costly duplication of effort by ensuring that every aspect of an operation is examined.
- C. Be tailored for the audit of each operation.
- D. Be generalized so as to be usable at various international locations of an organization.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 150

CORRECT ANSWER IS **C** . Its Explanation is

A tailored program will be more relevant to an operation than will a generalized program.

INCORRECT CHOICES EXPLANATION

Explanation for A:

A generalized program cannot take into account variations resulting from changing circumstances and varied conditions.

Explanation for B:

Every aspect of an operation need not be examined—only those likely to conceal problems and difficulties.

Explanation for D:

A generalized program cannot take into account variations in circumstances and conditions.

Section B – Planning the Engagement

MULTIPLE CHOICE QUESTION NO. 151

If electronic funds transfer (EFT) is used to pay vendor invoices, which of the following computer- assisted audit procedures would an auditor use to determine if any payments were made twice?

- I. Identification of EFT transactions to the same vendor for the same dollar amount.
- II. Extraction of EFT transactions with unauthorized vendor codes.
- III. Testing of EFT transactions for reasonableness.
- IV. Searching for EFT transactions with duplicate purchase order numbers.

- A. I and IV only.
- B. III and IV only.
- C. I and II only.
- D. II and III only.

Section B – Planning the Engagement

ANSWER TO QUESTION NO. 151

CORRECT ANSWER IS **A** . Its Explanation is

I, IV. Correct. These tests can identify duplicate payments.

II, III. Incorrect. Selection of transactions with unauthorized vendor codes and testing of transactions for reasonableness do not identify duplicate payments.

INCORRECT CHOICES EXPLANATION

Explanation for B:

See the correct answer for an explanation.

Explanation for C:

See the correct answer for an explanation.

Explanation for D:

See the correct answer for an explanation.

SECTION C - PERFORMING THE ENGAGEMENT



This section has weightage of 40%
in exams and contains the 386
Multiple Choice Questions (MCQs).

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 1

An internal auditor has obtained the following data by selecting a random sample from an inventory population:

	Number of Items	Audited Value	Carrying Amount
Sample	200	\$220,000	\$200,000
Population	5,000		\$5,200,000

The estimate of the population dollar value using difference estimation sampling is

- A. \$5,500,000
- B. \$5,680,000
- C. \$5,700,000
- D. \$4,700,000

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 1

CORRECT ANSWER IS **C** . Its Explanation is

The estimate of the population dollar value using difference estimation sampling would be \$5,700,000. To calculate:

(1) Subtract the audited value by the carrying value and divide by number of items = \$100 $((\$220,000 - \$200,000) / 200)$.

(2) Multiple \$100 by the population = \$500,000 $(\$100 \times 5,000)$.

(3) Add this number to the book value = \$500,000 + \$5,200,000 = \$5,700,000.

Note: If the audited value is greater than the book value, then add the number. On the other hand, if the audited value is less than the book value, then subtract from the carrying value.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The correct answer is \$5,700,000. The answer \$5,500,000 is based on mean-per-using sampling.

Explanation for Choice B:

The correct answer is \$5,700,000.

Explanation for Choice D:

The correct answer is \$5,700,000

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 2

When relatively few items of high dollar-value constitute a large proportion of an account balance, stratified sampling techniques and complete testing of the high dollar-value items will generally result in a

- A. Reduction in sample size.
- B. Simplified evaluation of sample results.
- C. Larger estimate of population variability.
- D. Smaller non-sampling error.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 2

CORRECT ANSWER IS **A** . Its Explanation is

In stratified sampling, the auditor breaks the population into different levels based on the size of the items within the population. This generally results in a reduced sample size. An advantage of stratifying is that it allows the auditor to concentrate on the larger or more important items.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Stratifying a population does not result in a simplified evaluation of sample results since stratifying requires combining sample results from more than one sample.

Explanation for Choice C:

If properly used, stratified sampling will result in smaller estimate of population variability.

Explanation for Choice D:

Stratified sampling does not result in a smaller error. Non-sampling error is independent of sample selection. Non-sampling

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 3

Depoole Company is a manufacturer of industrial products and employs a calendar year for financial reporting purposes. Assume that total quick assets exceeded total current liabilities both before and after the transaction described. Further assume that Depoole has positive profits during the year and a credit balance throughout the year in its retained earnings account.

The collection of a current accounts receivable of 29,000 would

- A. Increase the current ratio.
- B. Not affect the current or quick ratios.
- C. Increase the quick ratio.
- D. Decrease the current ratio and the quick ratio.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 3

CORRECT ANSWER IS **B** . Its Explanation is

When a receivable is collected, there is no change in the quick or the current ratios. This is because this transaction does not change the level of current assets or current liabilities. When a receivable is collected, the company is simply exchanging one current and quick asset (receivables) for another current and quick asset (cash) of the same amount. Therefore, the current and quick ratios do not change.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The collection of a receivable will not change the current ratio. Cash will increase by the same amount that receivables decrease, so current assets will be unchanged. See the correct answer for a complete explanation.

Explanation for Choice C:

The collection of a receivable will not change the quick ratio. Cash will increase by the same amount that receivables decrease, so quick assets will be unchanged. See the correct answer for a complete explanation.

Explanation for Choice D:

The collection of a receivable will not change the current or quick ratios. Cash will increase by the same amount that receivables decrease, so both current assets and quick assets will be unchanged. See the correct answer for a complete explanation.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 4

Management of a telephone and cable television enterprise has requested an engagement to evaluate its service department. The department is responsible for handling all customer inquiries regarding telephone or cable performance and assigning staff personnel to fix the problem, installing new cable lines and hooking them up to the customer's home, selling complementary products such as designer telephones, selling complementary services such as premium cable television services, and additional telephone services such as call-waiting, three-line hookup, etc. Management is very customer oriented and has a policy that 95% of customer complaints or inquiries must be fully addressed to the customer's satisfaction within 24 hours of receiving the call. All customer service inquiries that require a service technician must be logged in by the responding service agent. Although the department exists to handle customer needs, it is also viewed by management as a profit center. All revenue is generated from the sale of complementary services or equipment and from service revenue. The department has been in existence for only three years and management has not developed a mechanism to evaluate the department's performance. However, management is concerned that the department might not be meeting management's goals.

During the preliminary planning, the following information is gathered.

Preliminary Information	Current Year (2010)	Prev. Year (2009)	Prior Year (2008)
Number of complaints logged	37,500	35,000	34,000
Number of service calls at customer locations	10,080	10,000	8,640
Number of customers	1,250,000	1,100,000	1,000,000
Service call revenue	\$510,000	\$500,000	\$432,000
Sales of complementary services or equipment	\$6,250,000	\$4,400,000	\$3,750,000
No. of Staff	Supp. Staff-7	Supp. Staff-7	Supp. Staff-5
Technicians	Technicians-7	Technicians-7	Technicians-6
Total Service Department Costs	\$1,344,000	\$1,275,000	\$1,056,000

The best engagement procedure to determine whether the organization is meeting its objective of satisfying 95% of customer inquiries within 24 hours is to

- A. Select a mean-per-unit statistical sample from the total population base and trace the sample to the customer complaint log to determine whether or not 95% of the sample had their complaints addressed within 24 hours.
- B. Develop a customer satisfaction survey and send it to all customers, and include a question about the timeliness of service.
- C. Develop a customer satisfaction survey and send it to a statistically selected sample of customers based on mean-per-unit sampling and ask them to identify the time it took for the service department to satisfactorily address their problem. Calculate a mean and standard deviation.
- D. Select an attribute sample from the population of logged-in customer complaints and trace to records indicating its disposition, noting time and nature of disposition.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 4

CORRECT ANSWER IS **D** . Its Explanation is

The best engagement procedure to determine whether the organization is meeting its objective of satisfying 95% of customer inquiries within 24 hours is to select an attribute sample from the population of logged-in customer complaints and trace to records indicating its disposition, noting time and nature of disposition. This procedure should provide evidence of when the customers were serviced.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Mean-per-unit (MPU) testing is not appropriate. MPU is a variable sampling technique and variable sampling is used to test account balances and transactions, not to test controls.

Explanation for Choice B:

Developing a customer satisfaction survey and sending to all customers would be costly and still might not provide the necessary information: (1) the customer might not respond, and (2) is highly unlikely the customer is going to remember the timeliness of service unless the service was unusual; either very fast, or very slow.

Explanation for Choice C:

Sending out a survey might not provide the necessary information: (1) the customer might not respond, and (2) it is highly unlikely the customer is going to remember the timeliness of service unless the service was unusual; either very fast, or very slow. Also, MPU is a variable sampling technique. Variable sampling is used to test account balances and transactions, not to test controls.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 5

An example of an internal nonfinancial benchmark is

- A. The percentage of customer orders delivered on time at the company's most efficient plant.
- B. A \$50,000 limit on the cost of employee training programs at each of the company's plants.
- C. The average actual cost per pound of a specific product at the company's most efficient plant.
- D. The labor rate of comparably skilled employees at a major competitor's plant.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 5

CORRECT ANSWER IS **A** . Its Explanation is

Benchmarking is a continuous process that entails both quantitative and qualitative measurement of the difference between the performance of an activity and the performance by the best (either within the company or outside the company). The percentage of customer orders delivered on time at the company's most efficient plant is an example of a nonfinancial benchmark.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

A dollar limit on training programs is a financial benchmark.

Explanation for Choice C:

A product's average actual cost per pound is a financial benchmark.

Explanation for Choice D:

The labor rate of comparably skilled employees at a major competitor's plant is a financial benchmark.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 6

In obtaining a sample for the purpose of reaching a conclusion about the population from which it is drawn, the internal auditor

- A. Will usually use random sampling with replacement.
- B. Cannot use random sampling procedures unless the items to be sampled are available in machine-readable form.
- C. Should use judgmental sampling and concentrate on high-risk items.
- D. Can statistically quantify the sample results only if the sample was selected in such a way that each population item has an equal or known probability of selection.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 6

CORRECT ANSWER IS **D** . Its Explanation is

The only way to statistically evaluate a sample is if each item has an equal or known probability of selection.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Sampling without replacement is normal.

Explanation for Choice B:

Random sampling does not require machine-readable data.

Explanation for Choice C:

Judgement sampling is an unsatisfactory alternative for reaching conclusions about a population.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 7

In testing the write-off of a deteriorated piece of equipment, the best information about the condition of the equipment is

- A. A physical inspection of the actual piece of equipment.
- B. The equipment manager's statement regarding condition.
- C. The production department's equipment downtime report.
- D. Accounting records showing maintenance and repair costs.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 7

CORRECT ANSWER IS **A** . Its Explanation is

Observing the actual condition of the equipment is the most reliable and conclusive information for the internal auditor to determine the condition of the equipment.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

The equipment manager's statement regarding condition of the equipment is not conclusive information.

Explanation for Choice C:

The production department's equipment downtime report will be less reliable and persuasive than the internal auditor's observation.

Explanation for Choice D:

Accounting records showing maintenance and repair costs is not conclusive information.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 8

Which of the following states an inappropriate policy relating to the retention of engagement working papers?

- A. Working papers should be disposed of when they have no further use.
- B. Working papers retention schedules should be approved by legal counsel.
- C. Working papers prepared for fraud investigators should be retained indefinitely.
- D. Working papers retention schedules should consider legal and contractual requirements.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 8

CORRECT ANSWER IS **C** . Its Explanation is

No working papers will have to be retained indefinitely, even for fraud investigations.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The retention period should be determined by usefulness, and other considerations, i.e., law or other contractual agreements.

Explanation for Choice B:

The retention period should be determined by usefulness, and other considerations, i.e., law or other contractual agreements.

Explanation for Choice D:

The retention period should be determined by usefulness, and other considerations, i.e., law or other contractual agreements.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 9

An operational engagement relating to the production function includes a procedure to compare actual costs with standard costs. The purpose of this engagement procedure is to

- A. Determine the accuracy of the system used to record actual costs.
- B. Assess the reasonableness of standard costs.
- C. Measure the effectiveness of the standard cost system.
- D. Assist management in its evaluation of effectiveness and efficiency.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 9

CORRECT ANSWER IS **D** . Its Explanation is

An operational engagement is concerned with examining and evaluating systems of internal control, overall company operations, and the quality of performance in carrying out assigned responsibilities. The purpose of an operational engagement is to assist management in its evaluation of effectiveness and efficiency. A comparison between actual costs and standard costs can be used to fulfill that purpose.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

An operational engagement is concerned with examining and evaluating systems of internal control, overall company operations, and the quality of performance in carrying out assigned responsibilities. The purpose of an operational engagement is to assist management in its evaluation of effectiveness and efficiency. A comparison between actual costs and standard costs will not necessarily fulfill that purpose.

Explanation for Choice B:

An operational engagement is concerned with examining and evaluating systems of internal control, overall company operations, and the quality of performance in carrying out assigned responsibilities. The purpose of an operational engagement is to assist management in its evaluation of effectiveness and efficiency. A comparison between actual costs and standard costs will not necessarily fulfill that purpose.

Explanation for Choice C:

An operational engagement is concerned with examining and evaluating systems of internal control, overall company operations, and the quality of performance in carrying out assigned responsibilities. The purpose of an operational engagement is to assist management in its evaluation of effectiveness and efficiency. A comparison between actual costs and standard costs will not necessarily fulfill that purpose.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 10

Windham Company has current assets of 400,000 and current liabilities of 500,000. Windham Company's current ratio would be increased by

- A. Refinancing a 100,000 long-term loan with short-term debt.
- B. The purchase of 100,000 of inventory on account.
- C. The payment of 100,000 of accounts payable.
- D. The collection of 100,000 of accounts receivable.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 10

CORRECT ANSWER IS **B** . Its Explanation is

Currently, the current ratio is 0.8. This transaction would increase current assets to 500,000 and current liabilities to 600,000. After this, the current ratio would be 0.833, an increase.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Currently, the current ratio is 0.8. This transaction would increase current liabilities to 600,000 and current assets would remain unchanged. After this, the current ratio would be 0.667, a decrease, not an increase.

Explanation for Choice C:

Currently, the current ratio is 0.8. This transaction would decrease current assets to 300,000 and current liabilities to 400,000. After this, the current ratio would be 0.75, a decrease, not an increase.

Explanation for Choice D:

This transaction would have no impact on the current ratio because all that is happening is the current asset of accounts receivable is being converted into the current asset of cash.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 11

The internal auditor for a diversified organization is performing a preliminary analytical review of the home building division. The division accounts for approximately 15% of the organization's revenues and profits. It operates in the Southwest region of the country and has been growing rapidly. New management took over the division during the early part of 2009 and has been very aggressive in pushing market share and growth. Management is considering expanding operations to new regions because of (1) demonstrated growth and profitability potential; and (2) a potential slowing of growth in the Southwest region. The division views itself as the efficient home builder in the region. The following data have been compiled for your review.

Southwest Housing Division Selected Financial and Building Data

Attribute	Year End Sept. 2010 (Unaudited)	Year End Sept. 2009	Year End Sept. 2008	Year End Sept. 2007
No. of New Housing Starts in Region	62,500	57,500	52,800	47,500
Division Revenue	\$156.3 million	\$119.0 million	\$110.4 million	\$83.2 million
Net Income as Percent of Revenue	11.52%	11.34%	9.96%	9.37%
Net Income	\$18 million	\$13.5 million	\$11.0 million	\$7.8 million
Relative Market Share	20%	18%	19%	17%
No. of Houses Built	1,250	1,035	1,003	808
Average Revenue Generated per Home Built.	\$125,000	\$115,000	\$110,000	\$103,000
Housing Price Index for Area	1.2	1.15	1.1	1.03
No. of Employees	233	180	167	150
Home Building Materials Price Index	1.25	1.2	1.05	1.0
Jobs in Progress at Year-End	80	40	25	18
Accrued Revenue per Job in Progress	\$100,000	\$43,750	\$52,500	\$48,000
Goodwill per Balance Sheet	\$11.3 million	\$0	\$0	\$0
Long Term Debt	\$50 million	\$10 million	\$10 million	\$5 million
Debt/Equity Ratio	1.25	0.26	0.25	0.15

Which of the following would best describe the reason that the division has experienced growth in both the number of employees and market share during 2010?

- A. Acquisition of another building company during the year.
- B. Increased productivity per employee.
- C. Increase in number of jobs in progress at year-end.
- D. Increase in the housing price index for the region.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 11

CORRECT ANSWER IS **A** . Its Explanation is

This is the most likely rationale for the increases. This conclusion is corroborated by the increase in goodwill and long-term debt during the year.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

There is a decrease in productivity per employee, that is, there is less housing production per employee in 2010.

Explanation for Choice C:

The increase in jobs in progress at year-end indicates potential problems in productivity and management, but does not provide a rationale for the increase in market share.

Explanation for Choice D:

The increase in housing price index would have very little to do with the increase in employees and market share.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 12

An important difference between a statistical and a judgmental sample is that with a statistical sample,

- A. More accurate results are obtained.
- B. Population estimates with measurable reliability can be made.
- C. A smaller sample can be used.
- D. No judgment is required because everything is computed according to a formula.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 12

CORRECT ANSWER IS **B** . Its Explanation is

An important difference between statistical and non-statistical sampling is that with statistical sampling population estimates with measurable reliability can be made. Statistical sampling provides a means of quantitatively assessing precision and confidence level.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The accuracy of the results is not dependent of whether statistical or non-statistical sampling is used.

Explanation for Choice C:

Using statistical sampling may result in a larger sample.

Explanation for Choice D:

Judgment is still required to determine confidence level, etc.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 13

Norton, Inc. has a 2-to-1 current ratio. This ratio would increase to more than 2 to 1 if

- A. a previously declared stock dividend was distributed.
- B. the company purchased inventory on open account.
- C. the company wrote off an uncollectible receivable.
- D. the company sold merchandise on open account that earned a normal gross margin.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 13

CORRECT ANSWER IS **D** . Its Explanation is

When the company sells inventory at a profit, current assets will increase because the receivable that is created is larger than the inventory that was sold (the difference is the profit on the transaction). This increase in current assets will increase the current ratio.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

A distribution of a stock dividend does not affect current assets or current liabilities because it is distributed in stock, not cash. Therefore, the current ratio would remain unchanged.

Explanation for Choice B:

When a company purchases inventory on account, both the current assets and the current liabilities of the company will increase by the cost of the inventory. Since the company currently has a current ratio of 2, an equal increase in the numerator and denominator will actually decrease the current ratio of the company because the **percentage** increase in current assets will be less than the **percentage** increase in current liabilities.

Explanation for Choice C:

Writing off a receivable will decrease both the receivables account and the related allowance for bad debts. Therefore, net receivables will remain unchanged and the current ratio will remain unchanged.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 14

A medium-sized municipality provides 8.5 billion gallons of water per year for 31,000 customers. The water meters are replaced at least every 5 years to ensure accurate billing. The water department tracks unmetered water to identify water consumption that is not being billed. The department recently issued the following water activity report:

	Month	Month	Month	1st Quarter	1st Quarter
Activity	One	Two	Three	Actual	Goal
Meters Replaced	475	400	360	1,235	1,425
Leaks Reported	100	100	85	285	
Leaks Repaired	100	100	85	285	100%
Unmetered Water	2%	6%	2%	4%	2%

Based on the activity reported for the unmetered water, an internal auditor would conclude that

- A. Further audit investigation of unmetered water is not warranted.
- B. Established operating standards are understood and are being met.
- C. Deviations from the goal were probably not corrected.
- D. The operating standard should be changed.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 14

CORRECT ANSWER IS **A** . Its Explanation is

Since month three results (2%) met the goal it is assumed that deviations from the goal were probably corrected. Therefore, no further investigation is warranted.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Since actual result was greater than planned established operating standards are not being met.

Explanation for Choice C:

Deviations from the goal were probably corrected.

Explanation for Choice D:

There is not enough information given to warrant changing the operating standards.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 15

In regards to sample size, which of the following statements are true?

- I. There is a direct relationship between population size and sample size.
- II. The lower the acceptable risk of error, the larger the sample size will need to be.
- III. The lower the tolerable error, the larger the sample will need to be.

- A. I only.
- B. I, II and III.
- C. II and III only.
- D. I and II only.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 15

CORRECT ANSWER IS **C** . Its Explanation is

Both items II and III are true. The lower the amount of error the auditor is willing to accept, the larger the sample size will need to be. This would also relate to the tolerable deviation rate in the population as well. The lower this number, the larger the sample will need to be.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Item I is false. There is not a direct relationship between population size and sample size.

Explanation for Choice B:

Item I is false. There is not a direct relationship between population size and sample size.

Explanation for Choice D:

While it is true that as the population size increases, the sample size should also increase as well, but there is not a direct relationship between the two. This means that if the population doubles in size, the sample will probably not double in size. Item II is true. The lower the amount of error the auditor will accept, the larger the sample size will need to be.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 16

The data presented below shows actual figures for selected accounts of McKeon Company for the fiscal year ended May 31, 20X0, and selected budget figures for the 20X1 fiscal year. McKeon's controller is in the process of reviewing the 20X1 budget and calculating some key ratios based on the budget. McKeon Company monitors yield or return ratios using the average financial position of the company. (Round all calculations to three decimal places if necessary.)

	May 31, 20X1	May 31, 20X0
Current assets	210,000	180,000
Noncurrent assets	275,000	255,000
Current liabilities	78,000	85,000
Long-term debt	75,000	30,000
Common stock (30 par value)	300,000	300,000
Retained earnings	32,000	20,000

20X1 Operations

Sales*	350,000
Cost of goods sold	160,000
Interest expense	3,000
Income taxes (40% rate)	48,000
Dividends declared and paid in 20X1	60,000
Administrative expense	67,000

*All sales are credit sales.

Composition of Current Assets

	May 31, 20X1	May 31, 20X0
Inventory	70,000	80,000
Other current assets	20,000	20,000
Accounts receivable	100,000	70,000
Cash	20,000	10,000
	210,000	180,000

The 20X1 accounts receivable turnover for McKeon Company is

- A. 3.500
- B. 1.882
- C. 4.118
- D. 5.000

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 16

CORRECT ANSWER IS **C** . Its Explanation is

Accounts receivable turnover is net credit sales divided by average accounts receivable. For McKeon, budgeted credit sales for 20X1 are 350,000 and the average accounts receivable is 85,000 (70,000 actual at the end of 20X0 and 100,000 projected at the end of 20X1). This gives us $350,000 \div 85,000 = 4.118$.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Accounts receivable turnover is net credit sales divided by average accounts receivable. This answer uses the expected 20X1 ending accounts receivable in the calculation instead of the average accounts receivable balance for 20X1. Average balances of balance sheet items are used instead of beginning or ending balances whenever a ratio calculation is relating an income statement amount to a balance sheet amount. This average balance amount should be the average balance of the balance sheet item during the same period of time as the income statement amount covers. This makes the relationship of the two amounts meaningful. The average balance is usually calculated as the average of the beginning and ending balances of the period. Therefore, the average accounts receivable balance for 20X1 is the average of the ending 20X0 and the ending 20X1 accounts receivable balances.

Explanation for Choice B:

This is cost of goods sold divided by average accounts receivable. Accounts receivable turnover is net credit sales divided by average accounts receivable.

Explanation for Choice D:

Accounts receivable turnover is net credit sales divided by average accounts receivable. This is sales divided by beginning accounts receivable (70,000 as of May 31, 20X0). Average balances of balance sheet items are used instead of beginning or ending balances whenever a ratio calculation is relating an income statement amount to a balance sheet amount. This average balance amount should be the average balance of the balance sheet item during the same period of time as the income statement amount covers. This makes the relationship of the two amounts meaningful. The average balance is usually calculated as the average of the beginning and ending balances of the period. Therefore, the average accounts receivable balance for 20X1 is the average of the ending 20X0 and the ending 20X1 accounts receivable balances.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 17

The chief audit executive (CAE) of internal auditing of a mid-sized internal auditing organization was concerned that management might outsource the internal auditing function. Therefore, the CAE adopted a very aggressive program to promote the internal auditing department within the organization.

The CAE planned to present the results to management and the audit committee and recommend modification of the Internal Audit Charter after using the new program.

In order to save time, the CAE no longer required that a standard internal control questionnaire be completed for each audit.

Is this a violation of the *Standards*?

- A. No. Auditors are not required to fill out internal control questionnaires on every audit.
- B. No. Auditors may omit necessary procedures if there is a time constraint. It is a matter of audit judgment.
- C. Yes. Internal control should be evaluated on every audit engagement and the internal control questionnaire is the most efficient method to do so.
- D. Yes. Internal control should be evaluated on every audit, but the internal control questionnaire is not the mandated approach to evaluate the controls.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 17

CORRECT ANSWER IS **A** . Its Explanation is

Internal auditors are required to reviewed internal controls, however, the review itself does not require the use of a standard internal control questionnaire.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Auditors cannot omit necessary procedures because of a time constraint.

Explanation for Choice C:

It is not a violation of the Standards.

Explanation for Choice D:

Internal control evaluations are not required on every audit.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 18

As part of the test of the effectiveness of a disaster recovery plan, the internal auditor plans to interview five employees from each of five different departments (25 employees in all). After the first few interviews, what is the best way for the internal auditor to remain attentive during the remaining interviews?

- A. Ask the questions in a slightly different format and in a different sequence.
- B. Make up completely different questions to stay interested.
- C. Have the rest of the employees write down their responses.
- D. Interview the remaining employees in groups of four or five.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 18

CORRECT ANSWER IS **A** . Its Explanation is

Asking the questions in a slightly different format and in a different sequence is a good method to break the monotony of the interviews.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Making up completely different questions to stay interested would not be effective since the results to the internal auditor's test depends on comparing responses to the same questions.

Explanation for Choice C:

Having the rest of the employees write down their responses would not be effective since written responses could differ from verbal responses. Also, interviewing gives the internal auditor an opportunity to observe and judge the employees.

Explanation for Choice D:

Interviewing the remaining employees in groups of four or five might not be as effective. Some of the employees might not be as forthcoming in a group setting, particularly, if they are critical of management. **771**

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 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 using the new program. One of the recommendations was that to save time, the CAE no longer required that a standard internal control questionnaire be completed for each engagement.

Is this inappropriate?

- A. No. Internal auditors may omit necessary procedures if there is a time constraint. It is a matter of professional judgment.
- B. Yes. Internal control should be evaluated on every engagement, but the internal control questionnaire is not the mandated approach to evaluate the controls.
- C. No. Internal auditors are not required to fill out internal control questionnaires on every engagement.
- D. Yes. Internal control should be evaluated on every engagement, and the internal control questionnaire is the most efficient method to do so.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 19

CORRECT ANSWER IS **C** . Its Explanation is

Internal auditors are not required to fill out a questionnaire on every engagement. This information may be contained in other working papers (i.e., flowcharts, checklists, etc.).

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Internal auditors may not omit necessary procedures if there is a time constraint.

Explanation for Choice B:

The evaluation of internal controls is not required on every engagement.

Explanation for Choice D:

The evaluation of internal controls is not required on every engagement.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 20

When reviewing engagement working papers, the primary responsibility of an engagement supervisor is to determine that

- A. Working papers are properly referenced and kept in logical groupings.
- B. Each worksheet is properly identified with a descriptive heading.
- C. Working papers adequately support the engagement observations, conclusions, and recommendations.
- D. Standard internal audit activity procedures are adhered to with regard to working paper preparation and technique.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 20

CORRECT ANSWER IS **C** . Its Explanation is

Engagement supervision includes determining whether engagement working papers adequately support engagement observations, conclusions, and recommendations (PA 2340-1).

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Working papers that are properly referenced and kept in logical grouping are not of major importance during review.

Explanation for Choice B:

Proper descriptive headings are not of major importance when reviewing working papers.

Explanation for Choice D:

Adhering to standard internal audit activity is not of major importance when reviewing working papers.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 21

An adequately documented working paper should

- A. Be concise but complete.
- B. Contain examples of all forms and procedures used by the engagement client.
- C. Not contain copies of engagement client records.
- D. Follow a unique form and arrangement.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 21

CORRECT ANSWER IS **A** . Its Explanation is

The working papers need to be prepared in a manner that is complete, yet concise. They should be prepared so that they will be easier to review and easier to follow at later dates.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Working papers should not contain unnecessary documents or information. They do not need to contain copies of every document tested or examined during the engagement.

Explanation for Choice C:

Working papers should contain copies of engagement client records if necessary.

Explanation for Choice D:

Working papers should be arranged in a logical manner.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 22

An internal auditor's working papers should be reviewed by the

- A. Audit committee of the board.
- B. Management of the organization's security division.
- C. Management of the engagement client.
- D. Chief audit executive.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 22

CORRECT ANSWER IS **D** . Its Explanation is

The auditor's working papers should be reviewed by the CAE. It is the CAE who is responsible for the performance of the review.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The audit committee will review summarized communications. The audit committee will rarely review the auditor's working papers.

Explanation for Choice B:

An organization's security division might need to review the auditor's working papers when conducting an investigation, but they are not part of the general review process.

Explanation for Choice C:

Management of the engagement client will rarely see or review the auditor's working papers.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 23

An internal auditor becomes concerned that fraud, in the form of payments to bogus entities, 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 procedures would be most effective in addressing the internal auditor's concerns?

- A. Use generalized audit software to list all major vendors by product line; select a sample of paid invoices to new vendors and examine information indicating that services or goods were received.
- B. Use generalized audit software to take a random sample of all expenditures under \$50,000 to determine whether they were properly approved.
- C. Develop a "snapshot" technique to trace all transactions by suspected buyers.
- D. Use generalized audit software to list all purchases over \$50,000 to determine whether they were properly approved.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 23

CORRECT ANSWER IS **A** . Its Explanation is

The auditor wants to know whether services or goods that were paid for, were received. The best method to test for this is to use generalized audit software, which will allow the auditor to effectively and efficiently extract sample data.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

The issue is whether the purchases were valid, not whether they were properly approved.

Explanation for Choice C:

This "snapshot" technique captures data only at a certain point in time. Thus, it would not be effective in addressing the internal auditor's concern.

Explanation for Choice D:

Purchases over \$50,000 must have someone else's approval other than the buyer's.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 24

In evaluating the quality of housekeeping services performed in a large hospital, the most reliable source of evidence would be

- A. Interviews with a sample of medical personnel.
- B. A review of housekeeping records maintained by the medical records department of the hospital.
- C. A review of survey forms returned by medical personnel directly to the manager of housekeeping services.
- D. Interviews with top hospital officials.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 24

CORRECT ANSWER IS **A** . Its Explanation is

Evidence gathered first-hand by the auditor and also originating with unbiased parties is considered most competent.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

The medical records department would be unlikely to maintain any records except those of patients.

Explanation for Choice C:

Prior to the auditor's visit, the manager could have removed survey forms with critical comments.

Explanation for Choice D:

It's unlikely top hospital officials would be able to evaluate the quality of the housekeeping services.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 25

An internal auditor is planning to use attribute sampling to test the effectiveness of a specific internal control related to approvals for cash disbursements. In attribute sampling, decreasing the estimated occurrence rate from 5% to 4% while keeping all other sample size planning factors exactly the same would result in a revised sample size that would be

- A. Smaller
- B. Indeterminate.
- C. Unchanged.
- D. Larger.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 25

CORRECT ANSWER IS **A** . Its Explanation is

Decreasing the estimated occurrence rate from 5% to 4% would result in a smaller revised sample size.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Decreasing the estimated occurrence rate from 5% to 4% would decrease the sample size.

Explanation for Choice C:

Changing one variable while holding the other factors constant will change the sample size.

Explanation for Choice D:

Decreasing the estimated occurrence rate from 5% to 4% would result in a smaller revised sample size, not larger.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 361

A good working paper for a bank reconciliation should include (either directly or through cross reference) all of the following except

- A. The cash balance per the general ledger as of the reconciliation date.
- B. A list of all deposits made during the period in question.
- C. A list of outstanding checks.
- D. A legend explaining all tick marks employed.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 361

CORRECT ANSWER IS **B** . Its Explanation is

Because bank reconciliations do not show a list of all deposits, only deposits in transit.

INCORRECT CHOICES EXPLANATION

Explanation for A:

See the correct answer for the explanation.

Explanation for C:

See the correct answer for the explanation.

Explanation for D:

Should be present.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 362

A significant part of the auditor's working papers will be the conclusions reached by the auditor regarding the audit area. In some situations, the supervisor might not agree with the conclusions and will ask the staff auditor to perform more work. Assume that after subsequent work is performed, the staff auditor and the supervisor continue to disagree on the conclusions documented in the working paper developed by the staff auditor. Which of the following audit department responses would not be appropriate?

- A. Note the disagreement and retain the notice of disagreement and follow-up work in the audit working papers.
- B. Both the staff auditor and the supervisor document their reasons for reaching different conclusions. Retain the rationale of both parties in the working papers.
- C. Present both conclusions to the chief audit executive (CAE) for resolution. The CAE may resolve the matter.
- D. Present both conclusions in the audit report and let management and the auditee react to both.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 362

CORRECT ANSWER IS **D** . Its Explanation is

This would not be an appropriate response. The CAE should determine the most reasonable conclusion and present that to the auditee and management. The issue of disagreements on the working papers should not necessarily affect the reporting to management unless the director of internal auditing believes that both conclusions are equally appropriate and it would enhance management's understanding to be presented with both.

INCORRECT CHOICES EXPLANATION

Explanation for A:

This would also be an appropriate action and is consistent with the *Standards*. This is an appropriate response since the CAE is ultimately responsible for the supervision of the audit staff as well as the quality of the working papers.

Explanation for B:

This would be an appropriate response.

Explanation for C:

This is an appropriate response since the CAE is ultimately responsible for the supervision of the audit staff as well as the quality of the working papers.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 363

Working papers provide the documentary support for the internal auditor's report. Which of the following is not a good practice for working papers?

- A. Working papers should be organized chronologically, i.e., with the papers prepared earliest at the front of the file.
- B. Working papers should be sufficient to support the internal auditors' report without additional verbal elaboration by the internal auditor.
- C. Working papers should be kept secure at all times to prevent accidental loss or unauthorized access.
- D. Internal auditors within a given organization should develop standardized methods for organization and documentation.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 363

CORRECT ANSWER IS **A** . Its Explanation is

Chronological organization would be ineffective.

INCORRECT CHOICES EXPLANATION

Explanation for B:

This is a good practice.

Explanation for C:

This is a good practice.

Explanation for D:

This is a good practice.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 364

Which of the following best explains the reason for a difference between two working paper indexing methods used by internal auditors?

- A. The method of one internal auditing manager might be prescribed by the Standards; the method of the other might be required by company policy only.
- B. One internal auditing manager might devise a method that simplifies the review process within a particular organization, and another might devise one uniform method to simplify the review process of vastly different organizations to be audited.
- C. One internal auditing manager might use that method specified by the organization's audit committee, and the other might use a method required by law.
- D. The method of one internal auditing manager might be prescribed by the Standards, but the method of the other might be required by law.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 364

CORRECT ANSWER IS **B** . Its Explanation is

Since there are many differences between organizations (for example, type, size, location, etc.), one internal auditing manager devises the working paper-indexing method that best suits his or her organization. On the other hand, another may have to audit many different organizations that are in that organization. Therefore, that manager devises one uniform indexing method that is compatible with all of the organizations audited so that the review process can be simplified.

INCORRECT CHOICES EXPLANATION

Explanation for A:

The *Standards* only requires that the audit working papers contain an index number, but they do not discuss or require a particular indexing method.

Explanation for C:

The audit committee does not specify any working paper indexing method. Furthermore, there are no laws that require a particular indexing method.

Explanation for D:

There are no laws that require a particular indexing method.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 365

During an examination of a time-and-attendance system, an internal auditor determined that control over the time card system was excellent, all employees recorded their vacation time on weekly time cards, and each time card was properly reviewed and signed by a plant supervisor. The auditor also discovered one worker with no vacation time recorded on any time card for the period audited. Which of the following is reasonable for the auditor to conclude?

- A. Organizational policy required plant workers to take vacation time each year.
- B. There were errors in the time cards for other employees.
- C. The one employee took no time off for vacation during the period audited.
- D. There was an error in the time cards for the one employee.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 365

CORRECT ANSWER IS **C** . Its Explanation is

Because it was determined that the controls over the time card system was excellent, and all procedures were followed, it is reasonable to conclude that the one employee simply did not take vacation during the year.

INCORRECT CHOICES EXPLANATION

Explanation for A:

Based on the information provided, we are not able to conclude anything about the vacation policy.

Explanation for B:

Because it was determined that the controls over the time card system was excellent, and all procedures were followed, to conclude that

there were errors in multiple employee time cards is not reasonable.

Explanation for D:

Because it was determined that the controls over the time card system was excellent, and all procedures were followed, to conclude that there was an error for this one employee is not reasonable.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 366

Which of the following best describes an internal auditor's initial responsibility regarding errors uncovered during a financial statement audit?

- A. Inform the audit committee.
- B. Assess the risk of misrepresentation.
- C. Discuss the situation with the engagement client.
- D. Report the material errors.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 366

CORRECT ANSWER IS **B** . Its Explanation is

When the auditor discovers an error during an engagement, they must assess the risk of that misrepresentation as a whole on the financial statements.

INCORRECT CHOICES EXPLANATION

Explanation for A:

The IAA does not initially report material errors when they are discovered. Further assessment and testing will be performed before it is reported to the audit committee.

Explanation for C:

The IAA does not initially discuss material errors with the client. Further assessment and testing will be performed before it is acted further upon.

Explanation for D:

The IAA does not initially report material errors when they are discovered. Further assessment and testing will be performed before it is reported.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 367

While testing a division's compliance with company affirmative action policies, an auditor found that:

- (1) Five percent of the employees are from minority groups.
- (2) No one from a minority group has been hired in the past year.

The most appropriate conclusion for the auditor to reach is that:

- A. Insufficient evidence exists of compliance with affirmative action policies.
- B. The division is violating the company's policies.
- C. The company's policies cannot be audited and hence cannot be enforced.
- D. With five percent of its employees from minority groups, the division is effectively complying.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 367

CORRECT ANSWER IS **A** . Its Explanation is

Without knowledge of guidelines for compliance, a reasonable conclusion cannot be reached.

INCORRECT CHOICES EXPLANATION

Explanation for B:

The fact that no minority has been hired this year is irrelevant without knowing the total hires for the period.

Explanation for C:

An affirmative action policy is clearly auditable.

Explanation for D:

This conclusion cannot be reached without knowledge of the actual company policy.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 368

An internal auditor has the following information available to write a memorandum on the progress of developing new engagement software for accounts receivable:

The programmers, who were to start on the sampling software last week, will not be able to start until next week.

The programmers want to purchase a commercially available software package.

The funds for the software are not in the budget.

By using the software, the programmers expect to complete their work on schedule.

The purchased software will reduce programming costs by substantially more than the cost of the software.

The programming of the sampling techniques is expected to be completed one week early.

The overall project is expected to be completed on time.

Except for the software package and the programming costs, the project is on budget.

The most important message for the internal auditor to convey to senior management is

- A. The project is expected to be completed on time and within budget.
- B. The development of the new software is behind schedule.
- C. The programmers want to buy new software.
- D. The programming of the sampling techniques will be completed one week early.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 368

CORRECT ANSWER IS **A** . Its Explanation is

The most important message for the internal auditor to convey to senior management is that the project will be completed on time and within the projected budget.

INCORRECT CHOICES EXPLANATION

Explanation for B:

The project is expected to be completed on time.

Explanation for C:

The software is expected to reduce costs, so the purchase of the software should not be the most important message to senior management.

Explanation for D:

Senior management is more concerned whether the entire project will be completed on scheduled, not if a specific part is completed early. Lower management would have an interest in this type of information.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 369

A report of airline ticket information, including fare class, purchase date, and lowest available fare, could be used to

- A. Compare a department's actual expenses to those budgeted.
- B. Assess compliance with a company's travel policy.
- C. Identify the cost of employee travel.
- D. Support business-expense tax deductions.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 369

CORRECT ANSWER IS **B** . Its Explanation is

Reporting provides feedback on these options as prescribed in the travel policy.

INCORRECT CHOICES EXPLANATION

Explanation for A:

Airline tickets are often charged to employee credit cards; departmental charges would be initiated by the expense report transaction.

Explanation for C:

Such information is preliminary; employees may change tickets and routings prior to their trip.

Explanation for D:

Documentation for the employer's business-expense deduction would include that filed with the employee business-expense report, which also establishes the business purpose of such expenditures.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 370

Which of the following statements regarding the review of work papers is true?

- A. Work papers should be initialed and dated by the reviewer as evidence of supervisory review.
- B. Engagement work papers should be approved by the client after completion.
- C. Work paper review notes should be retained for all engagements.
- D. Work papers that pertain to legal issues should be reviewed to ensure that all audit opinions and details are recorded.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 370

CORRECT ANSWER IS **A** . Its Explanation is

The reviewer of work papers should initial and date the work papers that they have reviewed.

INCORRECT CHOICES EXPLANATION

Explanation for B:

Work papers do not get approved by the client.

Explanation for C:

Work paper review notes do not need to be retained for all engagements.

Explanation for D:

Work papers that pertain to legal issues do not need to record all audit opinions and details.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 371

Which of the following best describes engagement supervision?

- A. Supervision is most important in the planning phase of the engagement to ensure appropriate coverage.
- B. The manager of each engagement has the ultimate responsibility for supervision.
- C. Supervision is a continuing process beginning with planning and ending with the conclusion of the engagement.
- D. Supervision is primarily exercised at the final review stage of an engagement to ensure the accuracy of the engagement communications.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 371

CORRECT ANSWER IS **C** . Its Explanation is

Supervision is a process that begins with planning and continues throughout the engagement (PA 2340-1.1).

INCORRECT CHOICES EXPLANATION

Explanation for A:

Supervision is a process that begins with planning and continues throughout the engagement (PA 2340-1).

Explanation for B:

The CAE is ultimately responsibility for engagement supervision, not the manager of each engagement.

Explanation for D:

Supervision is a process that begins with planning and continues throughout the examination, evaluation, communication, and follow-up phases of the engagement (PA 2340-1).

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 372

Which of the following involves managerial functions as a control device?

- A. Maintenance of a quality control department.
- B. Use of a corporate policy manual.
- C. Internal auditing.
- D. Supervision of employees.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 372

CORRECT ANSWER IS **D** . Its Explanation is

The best form of control over the performance of individuals is supervision. This is a managerial function.

INCORRECT CHOICES EXPLANATION

Explanation for A:

A quality control department is a form of internal review and therefore is not a managerial function. The manager of quality control should be independent of the operations reviewed.

Explanation for B:

This does not control; it only advises.

Explanation for C:

Internal reviews (such as internal auditing) should be independent of the operations reviewed, and are not a managerial function.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 373

Which of the following is the best approach for obtaining feedback from engagement clients on the quality of internal audit work?

- A. Ask questions during the exit interviews and send copies of the documented responses to the clients.
- B. Provide questionnaires to engagement clients at the beginning of each engagement and request that the clients complete and return them after the engagements.
- C. Call engagement clients after the exit interviews and send copies of the documented responses to the clients.
- D. Distribute questionnaires to selected engagement clients shortly before preparing the internal audit annual activity report.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 373

CORRECT ANSWER IS **B** . Its Explanation is

It is best practice to provide the questionnaire to the customer at the beginning of an engagement, either routinely or periodically, to complete after the engagement. The quality measures being used by the internal audit activity and the internal auditor are then clearly understood by the customer, and specific requirements and expectations can be noted by the internal auditor before the engagement begins. The customer can then assess the quality of the internal audit work during the engagement and complete the questionnaire after the engagement. This also encourages a continuous process of monitoring quality and feedback by the customer throughout the engagement.

INCORRECT CHOICES EXPLANATION

Explanation for A:

Requests for feedback from customers are best achieved by the customer completing a questionnaire designed for the purpose. Such questionnaires facilitate the development of useful quality performance measures and trends.

Explanation for C:

Requests for feedback from customers are best achieved by the customer completing a questionnaire designed for the purpose. Such questionnaires facilitate the development of useful quality performance measures and trends.

Explanation for D:

The questionnaire should be given to the customer at the beginning of the engagement for completion after the engagement. Distributing questionnaires long after the engagement is completed would be less useful because the information will not be fresh in the customer's mind.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 374

The auditor-in-charge for a financial audit of a global organization has assigned specific tasks to team members and reserved for himself the responsibility of maintaining contact with the managers of financial departments in eight countries. In reviewing the work papers of one auditor, the auditor-in-charge notes that some of the work is incomplete. The auditor explains that she is unfamiliar with the accounting practices and software systems used in this country and this has slowed her work considerably. How could the auditor-in-charge have managed this situation in a more efficient, effective manner?

- A. Align auditor skills and knowledge with area needs before making assignments.
- B. Allow more time in the schedule for the auditor to become more familiar with local practice and technology.
- C. Work more closely with the audit client to secure more support for the assigned auditor.
- D. Build enough slack into the schedule to deal with the types of problems that are likely to occur in a global project.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 374

CORRECT ANSWER IS **A** . Its Explanation is

The most efficient way to manage this situation is to avoid it through better planning. In this case, the knowledge and skills of audit team members should have been considered before making assignments. The auditor in question might have been assigned to a different country, or might have been teamed with an auditor who is more familiar with the country's practices and technology. The other suggestions are not efficient solutions.

INCORRECT CHOICES EXPLANATION

Explanation for B:

See the correct answer for an explanation.

Explanation for C:

See the correct answer for an explanation.

Explanation for D:

See the correct answer for an explanation.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 375

Which of the following steps works against effective listening?

- A. Understanding the speaker's steps to reach a solution.
- B. Recognizing the speaker's emotion.
- C. Helping the speaker to complete the point.
- D. Asking appropriate questions.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 375

CORRECT ANSWER IS **C** . Its Explanation is

By interrupting the speaker, even with good intentions, the listener may inhibit further communication and may be jumping to unwarranted conclusions.

INCORRECT CHOICES EXPLANATION

Explanation for A:

Listening to how a person is solving the problem allows the provision of comments on process as well as content.

Explanation for B:

Listening for emotions enables the detection of strong emotions inhibiting rational problem resolution and the likelihood of consensus.

Explanation for D:

Asking thoughtful questions shows that one is listening deeply and encourages people to arrive at their own solutions.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 376

Data-gathering activities such as interviewing operating personnel, identifying standards to be used to evaluate performance, and assessing risks inherent in a department's operations are typically performed in which phase of an audit engagement?

- A. Engagement program development.
- B. Preliminary survey.
- C. Fieldwork.
- D. Examination and evaluation of evidence.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 376

CORRECT ANSWER IS **B** . Its Explanation is

These activities are normally accomplished during the preliminary survey phase.

INCORRECT CHOICES EXPLANATION

Explanation for A:

The activities described must be performed before the engagement program can be developed.

Explanation for C:

The activities described must be performed before the fieldwork can be undertaken.

Explanation for D:

The activities described must be performed before the evidence can be examined or evaluated.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 377

Which of the following best describes the primary purpose of exit conferences?

- A. To elicit audit client concerns.
- B. To preview the audit report.
- C. To validate audit findings and conclusions.
- D. To present audit results.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 377

CORRECT ANSWER IS **D** . Its Explanation is

This is the primary purpose of the exit interview.

INCORRECT CHOICES EXPLANATION

Explanation for A:

This is not the primary purpose of the exit interview.

Explanation for B:

The exit conferences presents, it does not preview, the audit results.

Explanation for C:

This is not the primary purpose of the exit interview.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 378

An internal auditor is using an internal control questionnaire as part of a preliminary survey. Which of the following is the best reason for the auditor to interview management regarding the questionnaire responses?

- A. Interviewing is the least costly audit technique when a large amount of information is involved.
- B. Interviews provide the opportunity to insert questions to probe promising areas.
- C. Interviews are the most efficient way to upgrade the information to the level of objective evidence.
- D. Interviewing is the only audit procedure that does not require confirmation of the information obtained.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 378

CORRECT ANSWER IS **B** . Its Explanation is

If additional information is needed after receiving the questionnaire, an interview is an effective method to get that additional information.

INCORRECT CHOICES EXPLANATION

Explanation for A:

Interviewing is probably not the most cost effective method to collect a large amount of information because of the costs of both the interviewee and interviewer involved.

Explanation for C:

Information collected from an interviewee is only the perspective of that person and it may not be objective.

Explanation for D:

Information obtained in an interview still needs to be confirmed.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 379

What computer-assisted audit technique would an auditor use to identify a fictitious or terminated employee?

- A. Exception testing for payroll deductions.
- B. Tagging and tracing of payroll tax-rate changes.
- C. Recalculations of net pay.
- D. Parallel simulation of payroll calculations.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 379

CORRECT ANSWER IS **A** . Its Explanation is

This type of computer-assisted audit technique (CAAT) program can identify employees who have no deductions. This is important because fictitious or terminated employees will generally not have any deductions.

INCORRECT CHOICES EXPLANATION

Explanation for B:

In this type of CAAT program, certain actual transactions are “tagged,” and as they proceed through the system, a data file is created that traces the processing through the system and permits an auditor to subsequently review that processing. This would not, however, identify a fictitious or terminated employee.

Explanation for C:

A CAAT program can recalculate amounts such as gross pay, net pay, taxes and other deductions, and accumulated or used leave times. These recalculations can help determine if the payroll program is operating correctly or if employee files have been altered, but they would not identify a fictitious or terminated employee.

Explanation for D:

In a parallel simulation, data that were processed by the engagement client’s system are reprocessed through the auditor’s program to determine if the output obtained matches the output generated by the client’s system. This technique might identify problems with the client’s processing but would not identify a fictitious or terminated employee.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 380

In which of the following situations would observation not provide the most compelling audit evidence?

- A. Verification of the existence of production equipment.
- B. Identification of excess inventory.
- C. Analysis of the security of a storeroom or facility.
- D. Documentation of a production or accounting process.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 380

CORRECT ANSWER IS **B** . Its Explanation is

Observation would not provide excellent evidence about excess inventory because the auditor would usually also need to confirm through other sources that the amount of inventory is excessive.

INCORRECT CHOICES EXPLANATION

Explanation for A:

Observation would provide the most compelling evidence for the verification of the existence of production equipment.

Explanation for C:

Observation would provide the most compelling evidence about the security of a storeroom or facility.

Explanation for D:

Observation would provide the most compelling evidence about the documentation of a production or accounting process.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 381

An internal auditor observes that controls over the perpetual inventory system are weak. An appropriate engagement response is to

- A. Increase the testing of the inventory controls.
- B. Perform turnover ratio tests.
- C. Apply gross profit analyses by product lines and compare the results with prior-years' information for reasonableness.
- D. Recommend that a physical inventory count be scheduled.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 381

CORRECT ANSWER IS **D** . Its Explanation is

The most appropriate response would be to recommend a physical inventory count. Observing a physical inventory count would be the most persuasive form of information.

INCORRECT CHOICES EXPLANATION

Explanation for A:

If the internal auditor observes that controls are weak then increasing the testing of controls would probably be inefficient.

Explanation for B:

Performing turnover ratio tests would not provide sufficient information.

Explanation for C:

Applying gross profit analyses would not be sufficient.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 382

A flowchart of process activities and controls may provide:

- A. Information on the extent of a past fraud.
- B. Information on where fraud could occur.
- C. An indication of where fraud has occurred in a process.
- D. No information related to fraud prevention.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 382

CORRECT ANSWER IS **B** . Its Explanation is

By indicating control weaknesses, flowcharts show where fraud may occur.

INCORRECT CHOICES EXPLANATION

Explanation for A:

Flowcharts do not provide any evidence of the extent of fraud.

Explanation for C:

Other procedures would be needed to detect where fraud has occurred.

Explanation for D:

Flowcharts provide evidence of where fraud can occur. Flowcharts therefore help in prevention.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 383

Reviewing an edit listing of payroll changes processed during each payroll cycle would most likely reveal:

- A. A failure to offer employees an opportunity to contribute to their pension plan.
- B. Undetected errors in the payroll rates of new employees.
- C. Labor hours charged to the wrong account in the cost reporting system.
- D. Inaccurate payroll deductions.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 383

CORRECT ANSWER IS **B** . Its Explanation is

Only a category such as new employee would generate a payroll change. By reviewing the list of changes to the payroll information during a period, unauthorized changes to payroll rates would be discovered.

INCORRECT CHOICES EXPLANATION

Explanation for A:

This is not applicable to a listing of payroll changes.

Explanation for C:

This data should come from the time reporting system (timecard or timesheet). It is not a payroll change.

Explanation for D:

The computer calculates this. It is not a change and would not be on the list.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 384

A company uses a linear regression formula ($Y = a + b(x)$) to estimate its total manufacturing costs. The formula used by the company is

$$Y = \$66,067.18 + \$0.40(x).$$

Assuming the regression formula holds true, if the company planned to increase production by 20% from 200,000 to 240,000 units, the company could expect per unit manufacturing costs to:

- A. Increase by some amount greater than 5%.
- B. Decrease by some amount greater than 8%.
- C. Decrease by some amount greater than 20%.
- D. Increase by some amount greater than 15%.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 384

CORRECT ANSWER IS **B** . Its Explanation is

At a production level of 200,000 units, per unit cost is \$0.73. If we increase production by 20%, the cost goes down to \$0.6753. This represents a decrease of just over 8%. **Tip:** At a production level of 200,000 units, variable cost is greater than its fixed cost. Because of this, we know that decreases in per unit cost would have to be lower than the increase in production. Therefore, we can automatically eliminate "Decrease by some amount greater than 20%" as an answer. Also, because fixed cost (\$66,067.18) stays fixed, we know that per unit costs have to decrease, not increase. Therefore, we can eliminate "Increase by some amount greater than 5%" and "Increase by some amount greater than 15%" as possible answers. Thus, the only answer left is "Decrease by some amount greater than 8%." Therefore, without having to do a calculation, you could determine the correct answer.

INCORRECT CHOICES EXPLANATION

Explanation for A:

See the correct answer for an explanation.

Explanation for C:

See the correct answer for an explanation.

Explanation for D:

See the correct answer for an explanation.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 385

A company uses a linear regression formula ($Y = a + b(x)$) to estimate its total manufacturing costs. The formula used by the company is

$$Y = \$66,067.18 + \$0.40(x).$$

If R for the formula is 0.9470, the proportion of the total variation in (Y) that can be explained by variations in (x) is:

- A. 5.30%
- B. 10.32%
- C. 89.68%
- D. 94.70%

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 385

CORRECT ANSWER IS **C** . Its Explanation is

The coefficient of determination R is the proportion of the total variation in the dependent variable (Y) that can be explained by variations in the independent variable (x). Therefore, if we square R , then the correct answer is 0.8968.

INCORRECT CHOICES EXPLANATION

Explanation for A:

See the correct answer for an explanation.

Explanation for B:

See the correct answer for an explanation.

Explanation for D:

See the correct answer for an explanation.

Section C – Performing the Engagement

MULTIPLE CHOICE QUESTION NO. 386

When conducting a performance appraisal of an internal auditor who has been a below-average performer, it is not appropriate to:

- A. Document the appraisal.
- B. Notify the internal auditor of the upcoming appraisal several days in advance.
- C. Use objective, impartial language.
- D. Use generalizations.

Section C – Performing the Engagement

ANSWER TO QUESTION NO. 386

CORRECT ANSWER IS **D** . Its Explanation is

It is not appropriate to use generalizations when giving a performance appraisal to a below-average performer. Rather, the evaluator must cite specific information and be prepared to support assertions with evidence.

INCORRECT CHOICES EXPLANATION

Explanation for A:

In a performance appraisal of a below-average performer, it is appropriate and advisable to notify the employee of the upcoming appraisal, use objective language, and document the appraisal.

Explanation for B:

In a performance appraisal of a below-average performer, it is appropriate and advisable to notify the employee of the upcoming appraisal, use objective language, and document the appraisal.

Explanation for C:

In a performance appraisal of a below-average performer, it is appropriate and advisable to notify the employee of the upcoming appraisal, use objective language, and document the appraisal.

SECTION D - COMMUNICATING ENGAGEMENT RESULTS AND MONITORING PROGRESS

This section has weightage of 20% in exams and contains the 208 Multiple Choice Questions (MCQs).

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 1

The following information is extracted from a draft of an engagement communication prepared upon the completion of an engagement to review the inventory warehousing procedures for a division.

Observations and Recommendations

We performed extensive tests of inventory record keeping and quantities on hand. Based on our tests, we have concluded that the division carries a large quantity of excess inventory, particularly in the area of component parts. We expect this is due to the conservatism of local management that does not want to risk shutting down production if the goods are not on hand. However, as noted earlier in this engagement communication, the excess inventory has led to a higher-than-average level of obsolete inventory write-downs at this division. We recommend that production forecasts be established, along with lead times for various products, and used in conjunction with economic order quantity concepts to order and maintain appropriate inventory levels.

A major writing problem in the paragraph is

- A. The presentation of observations before recommendations. The engagement communication would have more impact if recommendations are made before the observations are discussed.
- B. The use of potentially emotional words such as "conservatism" of local management.
- C. The reference to other parts of the engagement communication citing excessive inventory write-downs for obsolescence is not appropriate. If there is a problem, it should all be discussed within the context of the specific engagement observation.
- D. The specific identification of "component parts" may be offensive to the personnel responsible for those parts and may reflect negatively on them.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 1

CORRECT ANSWER IS **B** . Its Explanation is

The internal auditor should try to avoid using emotional words such as "conservatism" used to describe local management. This word could be considered offensive to the engagement client.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Since this is the observations and recommendations section of the engagement communications it is appropriate to present the observations before presenting the recommendations.

Explanation for Choice C:

In this case, citing excessive inventory write-downs for obsolescence would be considered appropriate.

Explanation for Choice D:

The term "component parts" is not considered to be offensive.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 2

The following information is to be included in a finding of an inventory control audit of a tent and awning manufacturer. The issue relates to overstocked rope.

- I. The quantity on hand at the time of the audit represented a 10-year supply based on normal usage.
- II. The company had held an open house of its new factory two months prior to the audit and had used the rope to provide safety corridors through the plant for visitors. This was not considered when placing the last purchase order.
- III. Rope is reordered when the inventory level reaches a one-month supply and is based on usage during the previous twelve months.
- IV. The quantity to be ordered should be adequate to cover expected usage for the next six months.
- V. The purchasing department should review inventory usage and inquire about any unusual fluctuations before placing an order.
- VI. A public warehouse, costing \$500 per month, was required to store the rope.
- VII. The purchasing agent receives an annual salary of \$59,000

Which of these statements should be in the **cause** section of the finding?

- A. VI only .
- B. VII only.
- C. II only.
- D. I only.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 2

CORRECT ANSWER IS **C** . Its Explanation is

This should be reported in the cause section.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

This belongs in the effect section.

Explanation for Choice B:

This should not be included in the report.

Explanation for Choice D:

This belongs in the condition section.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 3

Communication skills are important to internal auditors. They should be able to convey effectively all of the following to engagement clients **except**

- A. The objectives designed for a specific engagement.
- B. The risk assessment used in selecting the area for investigation.
- C. The engagement evaluations based on a preliminary survey.
- D. Recommendations that are generated in relationship to a specific engagement client.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 3

CORRECT ANSWER IS **B** . Its Explanation is

Internal auditors should be skilled in oral & written communications so that they can clearly and effectively convey such matters as engagement objectives, evaluations, conclusions, and recommendations. However, risk assessment is not something that necessarily needs to be communicated.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Internal auditors should be able to effectively communicate engagement objectives.

Explanation for Choice C:

Internal auditors should be able to effectively communicate engagement evaluations.

Explanation for Choice D:

Internal auditors should be able to effectively communicate recommendations to the engagement client.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 4

Internal auditors realize that at times corrective action is not taken even when agreed to by the appropriate parties. This should lead an internal auditor to

- A. Write a follow-up engagement communication with all observations and their significance for operations.
- B. Allow management to decide when to follow-up because it is management's ultimate responsibility.
- C. Decide to conduct follow-up work only if management requests the internal auditor's assistance.
- D. Decide the extent of necessary follow-up work.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 4

CORRECT ANSWER IS **D** . Its Explanation is

The internal audit activity's charter should define the responsibility for follow-up. The CAE determines the nature, timing, and extent of follow-up, considering the following factors: the significance of the reported observation or recommendation, the degree of effort and cost needed to correct the reported condition, the impacts that may result should the corrective action fail, the complexity of the corrective action, and the time period involved (PA 2500.A1-1).

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The follow-up engagement communication should not restate all observations.

Explanation for Choice B:

Follow-up is the responsibility of the internal auditor.

Explanation for Choice C:

Follow-up is the responsibility of the internal auditor.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 5

According to the *Standards*, the findings in an internal audit report should include

- A. Statements of both fact and opinion developed during the course of the audit.
- B. Statements of fact concerning the control weaknesses which were identified during the course of the audit.
- C. Statements that may deal with potential future events and might be helpful to the audited department.
- D. Statements of opinion about the cause of a finding.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 5

CORRECT ANSWER IS **B** . Its Explanation is

The *Standards* state, "Findings are pertinent statements of fact." Audit findings must be factual evidence regarding control strengths and weaknesses, which the auditor has found during the course of examination.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Audit findings cannot be both facts and opinions. They must only describe facts or conditions that exist.

Explanation for Choice C:

Audit findings deal with present, not future, factual conditions or events.

Explanation for Choice D:

Audit findings must be statements of fact rather than statements representing an auditor's opinion. Opinions (not findings) represent the auditor's evaluations of the effects of audit findings on the activities reviewed.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 6

During an engagement to perform an assurance service related to purchasing, the internal auditors found several violations of organizational policy concerning competitive bidding. The same condition had been reported in an engagement communication last year and corrective action had not been taken. Which of the following best describes the appropriate action concerning these repeat observations?

- A. The engagement communication should note that the same condition was reported in the prior engagement.
- B. During the exit interview, management should be informed that observations from the prior engagement communication have not been resolved.
- C. The chief audit executive (CAE) should determine whether management or the board has assumed the risk of not taking corrective action.
- D. The chief audit executive (CAE) should determine whether this condition should be reported to the independent external auditor and any regulatory agency.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 6

CORRECT ANSWER IS **C** . Its Explanation is

The CAE must establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

This action does not satisfy the internal auditor's full responsibly.

Explanation for Choice B:

This action does not satisfy the internal auditor's full responsibility.

Explanation for Choice D:

The CAE has to be very prudent in the use of internal information. No reason is given to indicate that either the external auditor or regulatory agency has to be informed.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 7

Which of the following is false with respect to the use of interim engagement communications? Interim engagement communications

- A. Are used to communicate information that requires immediate attention.
- B. Keep management informed of engagement progress when engagements extend over a long period of time.
- C. Are used to communicate a change in engagement scope for the activity under review.
- D. Eliminate the need for issuing final engagement communications.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 7

CORRECT ANSWER IS **D** . Its Explanation is

Interim reports are issued before the final report. These interim reports may be written or oral and they will be used to communicate: (1) information that requires immediate action; (2) a change in the scope of the engagement; and (3) the status of the project when the project is a long-term project. Interim reports do not eliminate the need for issuing final engagement communications.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Interim reports are used to communicate information that needs immediate action.

Explanation for Choice B:

Interim reports are used to communicate to management the status of the project when the project is a long-term project.

Explanation for Choice C:

Interim reports are used to communicate a change in the scope of the engagement.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 8

An internal audit activity (IAA) is conducting an engagement to evaluate the payroll and accounts receivable departments. Significant problems related to the approval of overtime have been noted. While the engagement is still in process, which of the following engagement communications is appropriate?

- A. A summary communication.
- B. A questionnaire-type communication.
- C. An oral communication.
- D. A final written communication.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 8

CORRECT ANSWER IS **C** . Its Explanation is

Interim reports are written or oral and may be transmitted formally or informally. Use interim reports to communicate information that requires immediate attention, to communicate a change in engagement scope for the activity under review, or to keep management informed of engagement progress when engagements extend over a long period. The use of interim reports does not diminish the need for a final report (PA 2410-1). Thus, an oral communication to the operating management outlining the significant problems would be appropriate.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Summary reports highlighting engagement results are appropriate for level of management above the engagement client and they can be issued separately from or in conjunction with the final report (PA 2410-1).

Explanation for Choice B:

A questionnaire-type report would be of little use in communicating significant problems.

Explanation for Choice D:

A final written communication would be submitted only when the engagement is completed.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 9

Which of the following is not included in the statement of scope in an engagement final communication?

- A. Activities not reviewed.
- B. Engagement objectives.
- C. Period covered by the engagement.
- D. Nature and extent of the work performed.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 9

CORRECT ANSWER IS **B** . Its Explanation is

The statement of Scope should identify which activities have been reviewed and the time period reviewed. If there have been related activities that have not been reviewed these should be identified to give a clear understanding of the parameters of the engagement. The nature and extent of engagement work performed will be clearly set out. The engagement objectives set out the purpose of the engagement, not the scope.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The statement of scope will specify the related activities not reviewed.

Explanation for Choice C:

The statement of scope specifies the period covered.

Explanation for Choice D:

The statement of scope will contain the nature and extent of the work performed.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 10

The internal auditing activity (IAA) encounters a scope limitation from senior management that will affect its ability to meet its goals and objectives for a potential engagement client. The nature of the scope limitation should be

- A. Communicated to the external auditors so they can investigate the area in more detail.
- B. Communicated to management stating that the limitation will not be accepted because it would impair the internal audit activity's independence.
- C. Noted in the engagement working papers, but the engagement should be carried out as scheduled and the scope limitation worked around, if possible.
- D. Communicated, preferably in writing, to the board.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 10

CORRECT ANSWER IS **D** . Its Explanation is

A scope limitation along with its potential effect must be communicated preferably in writing, to the board, audit committee, or other appropriate governing authority.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

There is no requirement for a scope limitation to be communicated to the external auditor.

Explanation for Choice B:

Conflicts with management should be communicated to the board.

Explanation for Choice C:

A scope limitation must be communicated to the board.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 11

Several levels of management are interested in the results of an engagement performed in the marketing department. What is the best method of communicating the results of the engagement?

- A. Write detailed communications for each level of management.
- B. Discuss results with all levels of management.
- C. Write a communication to the marketing management and give summary communications to other management levels.
- D. Discuss results with marketing management and issue a summary communication to senior management.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 11

CORRECT ANSWER IS **C** . Its Explanation is

It is recommended that the final engagement communications be distributed to those members of the organization who are able to ensure that engagement results are given due consideration. This means that the engagement communication should go to those who are in a position to take corrective action or to ensure that corrective action is taken. The final engagement communication should be distributed to the management of the activity under review. Thus, the marketing management would receive written communications and summary communications would be distributed to other management levels.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Each level of management will not receive detailed communications.

Explanation for Choice B:

Final engagement communications should be distributed to those members of the organization who are able to ensure that engagement results are given due consideration.

Explanation for Choice D:

The marketing management should receive written communications since they are the ones to take action.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 12

The following information is extracted from a draft of an engagement communication prepared upon the completion of an engagement to review the inventory warehousing procedures for a division.

Observations and Recommendations

We appreciate the cooperation of divisional management. We intend to discuss our observations with them and follow up by communicating your reaction to those recommendations included within this engagement communication. Given additional time for analysis, we feel that substantial opportunities are available for significant cost savings, and we are proud to be a part of the process.

A major deficiency in the paragraph is

- A. The observations were not discussed with division management before being presented to upper management.
- B. All of the answers are correct.
- C. The nature of the follow-up action is inappropriate.
- D. The cost savings mentioned are not supported in the engagement communication.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 12

CORRECT ANSWER IS **B** . Its Explanation is

All of the items described are deficiencies. The nature of the follow-up action is inappropriate. Follow-up is done only if the engagement client has agreed to corrective action. Also, observations should be discussed with divisional managers before the final engagement report is presented to senior management. Finally, the mentioned cost savings are not supported in the engagement communication.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

All of the items described are deficiencies.

Explanation for Choice C:

All of the items described are deficiencies.

Explanation for Choice D:

All of the items described are deficiencies.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 13

During an exit conference, the most effective way to motivate an auditee to adopt a recommendation on a control weakness would be to

- A. Inform the auditee that other line managers with fewer resources have been able to remedy similar situations.
- B. Remind the auditee that audit reports are read by senior management.
- C. Try to provide conclusive proof that the findings are correct and the conclusions are sound.
- D. Compliment the auditee on improvements already adopted and encourage further changes.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 13

CORRECT ANSWER IS **D** . Its Explanation is

This technique of positive reinforcement, which behavior modification theorists view as the most effective approach, provides rewards for certain responses, and it centers on desirable rather than undesirable behavior. Continuing reinforcement recognizes every occurrence of positive new behavior, while intermittent reinforcement provides intermittent rewards for established behavior. Examples would be paying an employee on a sliding scale corresponding to production output or giving merit-based salary bonuses.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

This type of negative comparison with other line managers is a demotivator.

Explanation for Choice B:

This appears to be a threat, which is not as effective as positive reinforcement.

Explanation for Choice C:

Although the auditor should try to provide conclusive proof, this is not directly related to motivation.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 14

Which of the following best defines an internal auditor's opinion expressed following an assurance engagement?

- A. A summary of the significant engagement observations.
- B. Recommendations for corrective action.
- C. Conclusions that must be included in the final engagement communication.
- D. The internal auditor's professional judgment about the situation that was reviewed.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 14

CORRECT ANSWER IS **D** . Its Explanation is

Conclusions (opinions) are the internal auditor's evaluations of the effects of the observations and recommendations on the activities reviewed. They usually put the observations and recommendations in perspective based upon their overall implications (PA 2410-1).

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Conclusions (opinions) are the internal auditor's evaluations of the effects of the observations and recommendations on the activities that were reviewed. A summary of the significant engagement observations is not an opinion.

Explanation for Choice B:

Recommendations for corrective action are not the same as the internal auditor's opinion. The opinion is the internal auditor's professional judgment about the situation that was reviewed.

Explanation for Choice C:

The standards do not state that opinions are required, but opinions can be a desirable component of the final engagement communication.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 15

Which of the following individuals would normally not receive an internal auditing report related to a review of the purchasing cycle?

- A. The general auditor.
- B. The independent external auditor.
- C. The director of purchasing.
- D. The chairman of the board of directors.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 15

CORRECT ANSWER IS **D** . Its Explanation is

The audit report should be distributed to everyone who has a direct interest in the audit. This includes the executive or executives to whom internal audit reports, the person to whom people will reply about the report, persons responsible for the activities or operations audited, and people who will need to take corrective action as a result of the audit. The board of directors usually should receive a summary report.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The audit report should be distributed to everyone who has a direct interest in the audit. This includes the executive or executives to whom internal audit reports, the person to whom people will reply about the report, persons responsible for the activities or operations audited, and people who will need to take corrective action as a result of the audit.

Explanation for Choice B:

The internal audit report should be distributed to everyone who has a direct interest in the audit. The independent external auditor would have a direct interest in the audit and thus should receive a copy of the report.

Explanation for Choice C:

The director of purchasing should properly receive an internal audit report related to a review of the purchasing cycle because the report should be distributed to everyone who has a direct interest in the audit. This includes the executive or executives to whom internal audit reports, the person to whom people will reply about the report, persons responsible for the activities or operations audited, and people who will need to take corrective action as a result of the audit.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 16

Internal audit reports should contain the purpose, scope, and results. The audit results should contain the criteria, condition, effect, and cause of the finding. The cause can **best** be described as

- A. Resultant evaluations of the effects of the findings.
- B. Reason for the difference between the expected and actual conditions.
- C. Factual evidence that the internal auditor found.
- D. The risk or exposure because of the condition found.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 16

CORRECT ANSWER IS **B** . Its Explanation is

The reason for difference between expected conditions and actual conditions is the cause of the finding.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Resultant evaluations of the effects of the findings are not the cause of the finding.

Explanation for Choice C:

Factual evidence is not the cause of the finding.

Explanation for Choice D:

The risk or exposure because of a condition found is not the cause of the finding.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 17

An auditor for a bank noted a significant deficiency relating to access to cash in the bank's vault at one of the branch banks. Which of the following is the most satisfactory means of addressing this deficiency? The auditor should

- A. Discuss the deficiency with the branch manager before drafting the written audit report. If the auditor and branch manager agree upon corrective action, include both the deficiency and corrective action in the audit report.
- B. Discuss the deficiency with the branch manager only after the audit report is published.
- C. Discuss the deficiency with the branch manager before drafting the written audit report. If the auditor and branch manager agree upon corrective action and the action is initiated before the report is published, the deficiency need not be included in the report.
- D. Not discuss the deficiency with the branch manager before or after the audit report is published; discussion may dilute the impact of the written report.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 17

CORRECT ANSWER IS **A** . Its Explanation is

This approach takes nothing away from the auditor, and it builds a problem-solving partnership between the auditor and branch manager.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Discussion prior to issuing the report helps ensure that there have been no misunderstandings nor misinterpretations of fact, and provides the branch manager the opportunity to clarify specific items.

Explanation for Choice C:

Top management should be made aware of significant deficiencies that have existed, even though they may have been corrected by the time the audit report is issued.

Explanation for Choice D:

Discussion prior to issuing the report helps ensure that there have been no misunderstandings nor misinterpretations of fact, and provides the branch manager the opportunity to clarify specific items.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 18

An internal auditor found that employees in the maintenance department were not signing their time cards. This situation also existed during the last engagement. The internal auditor should

- A. Withhold conclusions about payroll internal control in the maintenance department.
- B. Include this observation in the current engagement communication.
- C. Ask the manager of the maintenance department to assume the resulting risk.
- D. Instruct the employees to sign their time cards.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 18

CORRECT ANSWER IS **B** . Its Explanation is

Internal auditors must communicate the engagement results (Standard 2400). Thus, the internal auditor should include this observation in the current engagement communication.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The final engagement communication has to include conclusions about the payroll internal control in the maintenance department.

Explanation for Choice C:

It is not within the internal auditor's authority to ask the manager to assume the resulting risk. But, senior management may have decided to assume the risk of noncompliance.

Explanation for Choice D:

The internal auditor does not have the proper authority to instruct the employees to sign their time cards.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 19

You are conducting an engagement to evaluate the organization's marketing effort. You agreed to keep the marketing vice president informed of your progress on a regular basis. What method should be used for those progress reports?

- A. Written reports signed by the chief audit executive.
- B. Copies of working paper summaries.
- C. Oral or written interim reports.
- D. Briefing by the appropriate marketing first-line supervisor.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 19

CORRECT ANSWER IS **C** . Its Explanation is

Interim reports may be written or oral and may be transmitted formally or informally. Use Interim reports to communicate information that requires immediate attention, to communicate a change in engagement scope for the activity under review, or to keep management informed of engagement progress when engagements extend over a long period. The use of interim reports does not diminish the need for a final report (PA 2410-1).

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Interim reports may be written or oral.

Explanation for Choice B:

Engagement communications should be submitted to the engagement client, not working paper summaries.

Explanation for Choice D:

The internal auditor would submit the engagement communications, not the marketing first-line supervisor.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 20

A company's audit report stated:

"...Several items of equipment had been repaired by the maintenance department, even though the equipment was still under warranty..."

One purpose of this audit was to

- A. Determine the downtime percentage of the equipment.
- B. Ascertain the efficiency of the maintenance department at making repairs.
- C. Check for unnecessary repair costs.
- D. Determine if warranties are adequate given the company's repair experience.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 20

CORRECT ANSWER IS **C** . Its Explanation is

Based on the excerpt one possible engagement is to evaluate whether any equipment was repaired that was still under warranty. The repair cost of plant and equipment can be significant, so it is crucial for the company to know whether some unnecessary costs could have been avoided.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Based on the excerpt it is not known if determining the downtime percentage was the purpose of the audit.

Explanation for Choice B:

Based on the excerpt it is not known if ascertaining the efficiency of the maintenance department was the purpose of the audit.

Explanation for Choice D:

Based on the excerpt it is not known if determining if warranties are adequate given the company's repair experience was the purpose of the audit.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 21

An internal auditor has just completed an engagement and is in the process of preparing the final engagement communication. The observations in the final engagement communication should include

- A. Statements concerning potential future events that may be helpful to the engagement client.
- B. Statements of opinion about the cause of an observation.
- C. Pertinent factual statements concerning the control weaknesses uncovered during the course of the engagement.
- D. Statements of both fact and opinion developed during the course of the engagement.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 21

CORRECT ANSWER IS **C** . Its Explanation is

The final engagement communication should contain observations that are objective and factual. Pertinent factual statements concerning the control weaknesses uncovered during the course of the engagement would be appropriately included.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The final engagement communication should contain observations that are objective and factual. A statement concerning potential future events is inappropriate.

Explanation for Choice B:

The final engagement communication should contain observations that are objective and factual. A statement of opinion about the cause of an observation is inappropriate.

Explanation for Choice D:

The final engagement communication should contain observations that are objective and factual.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 22

One purpose of the exit interview is for the internal auditor to

- A. Review and verify the appropriateness of the engagement communication based upon client input.
- B. Review the performance of internal auditors assigned to the engagement.
- C. Present the final engagement communication to management.
- D. Require corrective action.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 22

CORRECT ANSWER IS **A** . Its Explanation is

The internal auditor should discuss conclusions and recommendations with the appropriate levels of management before the final communication is issued. This is usually done during the exit interview. One of the purposes of the meeting is to review and verify the appropriateness of the engagement communication based upon client input.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Reviewing the performance of the internal auditors assigned to the engagement is not done at the exit interview.

Explanation for Choice C:

The exit interview allows the internal auditor the opportunity to discuss conclusions and recommendations. The exit interview does not replace the final engagement communications since there may be modifications to the final report based on the results of the exit interview.

Explanation for Choice D:

The internal auditor can only recommend corrective action. It is management's responsibility to see that corrective action is taken.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 23

A multinational organization has an agreement with a value-added network (VAN) that provides the encoding and communications transfer for the organization's electronic data interchange (EDI) and electronic funds transfer (EFT) transactions. Before transfer of data to the VAN, the organization performs online preprocessing of the transactions. The internal auditor is responsible for assessing preprocessing controls. In addition, the agreement between the organization and the VAN states that the internal auditor is allowed to examine and report on the controls in place at the VAN on an annual basis. The contract specifies that access to the VAN can occur on a surprise basis during the second or third quarter of the fiscal year. This period was chosen so it would not interfere with processing during the VAN's peak transaction periods. This provision was not reviewed with internal auditing.

The annual engagement work schedule approved by the board of directors specifies that a full review would be done during the current year. When the internal auditor called to arrange the annual control review during the third quarter, the VAN stated that it could not accommodate the internal auditor because the peak processing period started earlier than normal this year and all VAN personnel were occupied. This scope limitation, along with its potential effect, must be communicated to which one of the following?

- A. The limitation does not need to be communicated at the board of director's level.
- B. The board of directors of both the organization and the VAN.
- C. The organization's board of directors.
- D. The board of directors of the VAN.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 23

CORRECT ANSWER IS **C** . Its Explanation is

A scope limitation is a restriction placed on the internal audit activity that precludes the activity from accomplishing its objectives and plans. A scope limitation occurs any time the auditors are not able to perform all of the tests that they would like to perform. A scope limitation along with its potential effect needs to be communicated, preferably in writing, to the board (PA 1130-1).

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The scope limitation would have to be communicated with the appropriate governing board.

Explanation for Choice B:

The internal auditor would not communicate with the board of the VAN.

Explanation for Choice D:

The internal auditor would not communicate with the board of the VAN.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 24

Successful consultative communication in an internal auditing engagement is partially based on feedback from engagement clients about internal auditors' actions during the engagement. This feedback

- A. Will keep clients on the defensive regarding the internal auditors.
- B. Should go to both management and the internal auditors to ensure business value is being added.
- C. Should go only to the internal auditors to help them improve their performance.
- D. Should go only to senior management as a means of reviewing the internal auditors.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 24

CORRECT ANSWER IS **B** . Its Explanation is

Feedback needs to be communicated to both management and the internal auditors to ensure that it is as beneficial as possible to the company. If it is received by only one of these parties, its benefit will be reduced as there will not be the level of accountability that there should be.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Because the client has the opportunity to provide feedback on the internal auditor, this should lead to a working relationship between the parties that is more open and professional.

Explanation for Choice C:

The feedback on the internal auditors also needs to be provided to management so that management can evaluate the IAA.

Explanation for Choice D:

The feedback also needs to go to the internal auditors so that they know how they can improve their performance.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 25

Internal audit activity (IAA) policy requires that final engagement communications not be issued without a management response. An engagement with significant observations is complete except for management's response. Evaluate the following courses of action and select the best alternative.

- A. Discuss the situation with the external auditors.
- B. Wait for management's response and then issue the engagement communication.
- C. Issue an interim engagement communication regarding the important issues noted.
- D. Modify the policy to allow a specific time period for management's response.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 25

CORRECT ANSWER IS **C** . Its Explanation is

Interim reports are reports that are issued before that final report. These interim reports may be written or oral and they will be used to communicate: (1) information that requires immediate action, (2) a change in the scope of the engagement, and (3) the status of the project when the project is a long-term project. Thus, the engagement with significant observations should be presented in an interim report.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Engagements with significant observations should be communicated promptly to management, not with external auditors.

Explanation for Choice B:

Engagements with significant observations should be communicated on a timely basis.

Explanation for Choice D:

Engagements with significant observations should be communicated on a timely basis.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 76

CORRECT ANSWER IS **A** . Its Explanation is

An interim report should be issued during the audit process whenever there is something that needs to be addressed immediately, or if there is a need to change the scope of the audit, or simply to keep people informed when the audit process is a long one. Open burning at a subsidiary plant which is a possible violation of pollution regulations is a situation in which an interim report is indicated because it is something that needs to be addressed immediately.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

An interim report should be issued during the audit process whenever there is something that needs to be addressed immediately, if there is a need to change the scope of the audit, or simply to keep people informed when the audit process is a long one. No significant adverse findings after 70% of the planned audit work has been completed is not a situation in which an interim report should be issued.

Explanation for Choice C:

An interim report should be issued during the audit process whenever there is something that needs to be addressed immediately, if there is a need to change the scope of the audit, or simply to keep people informed when the audit process is a long one. The auditors' decision to substitute survey procedures for some of the planned detailed review of certain records is not a situation in which an interim report should be issued.

Explanation for Choice D:

An interim report should be issued during the audit process whenever there is something that needs to be addressed immediately, if there is a need to change the scope of the audit, or simply to keep people informed when the audit process is a long one. While an indication of possible fraud implies that additional investigation is required, it is not a situation in which an interim report should be issued.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 77

An internal auditor finds that senior management has given tacit approval to activities that have resulted in prematurely recognizing revenue for goods that were not shipped. A preliminary investigation corroborates the internal auditor's initial observations. As part of the annual financial statement audit, the internal auditor coordinates work with the external auditor, who has asked to review the engagement working papers related to sales activities.

Assuming the amounts could be material to the financial statements, the internal auditor should report the observations to

- A. The external auditor as part of the process of sharing working papers.
- B. The audit committee because it is a significant accounting matter that should be addressed before the year-end audit report is issued.
- C. All of the answers are correct.
- D. The internal legal counsel to gain an assessment as to whether the action might constitute a fraud.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 77

CORRECT ANSWER IS **C** . Its Explanation is

All of answers are correct. Since the internal auditor is probably not a trained lawyer, the organization's internal legal counsel should be consulted. Because senior management is involved in the infraction, the audit committee should be informed, and the external auditors should be contacted in order to share information.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

In addition to the external auditor, the internal auditor should also report the observations to the internal legal counsel and audit committee.

Explanation for Choice B:

In addition to the audit committee, the internal auditor should also report the observations to the internal legal counsel and external auditor.

Explanation for Choice D:

In addition to the internal legal counsel, the internal auditor should also report the observations to the audit committee and external auditor.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 78

An audit found that the cost of some material installed on capital projects had been transferred to the inventory account because the capital budget had been exceeded. Which of the following would be an appropriate technique for the internal audit activity (IAA) to use to monitor this situation?

- A. Review all journal entries that transferred costs from capital to inventory accounts.
- B. Analyze a sample of capital transactions each quarter to detect instances in which installed material was transferred to inventory.
- C. Compare inventory receipts with debits to the inventory account and investigate discrepancies.
- D. Identify variances between amounts capitalized each month and the capital budget.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 78

CORRECT ANSWER IS **A** . Its Explanation is

There may be some legitimate reasons for transferring some capital costs to the inventory account. Thus, it is important for the internal auditor to review all journal entries that transferred costs from capital to inventory accounts.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

The internal auditor should review all journal entries, not just a sample. There may be some legitimate reasons for transferring some capital cost to the inventory account.

Explanation for Choice C:

There would be no inventory receipts for the transfers.

Explanation for Choice D:

Identifying variances between amounts capitalized each month and the capital budget does not consider the effects on the inventory budget.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 79

An auditor has submitted a first draft of an audit report to an auditee in preparation for an exit interview. The following is an excerpt from that report:

The audit was performed to accomplish several objectives - verify the existence of unused machinery being stored in the warehouse, determine whether machinery had been damaged during storage, review the handling procedures being performed by personnel at the warehouse, determine whether proper accounting procedures are being followed for machinery kept in the warehouse, calculate the current fair market value of warehouse inventories, and compare the total value of the machinery to company accounting records. It was confirmed that of the 30 machines selected from purchasing records for the sample, 10 were present on the warehouse floor and another five were on the loading dock ready for conveyance to the production facility. Twelve others had already been sent to the production facility at a previous time. An examination of the accounting procedures used at the warehouse revealed the failure by the warehouse accounting clerk to reconcile inventory records monthly, as required by policy.

A sample of 25 machines was examined for possible damage, and all but one was in good condition. It was confirmed by the auditors that handling procedures outlined in the warehouse policy manual appear to be adequate, and warehouse personnel apparently were following those procedures, except for the examination of items being received for inventory.

When communicating with auditees, there are both situational factors and message characteristics which can damage the communication process. An auditor has only limited control over situational factors but has substantial control over message characteristics.

Which of the following would seem to be a message characteristic that the auditor who prepared the above report overlooked?

- A. Sequence of message.
- B. Noise.
- C. Nature of the audience.
- D. History of prior events leading to the current encounter.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 79

CORRECT ANSWER IS **A** . Its Explanation is

Complex messages are more understandable if they follow a logical sequence. Thus, the sequence or organization of the message is a characteristic that is within the control of the sender.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Noise is a situational factor that interferes with the effective communication of intended messages.

Explanation for Choice C:

The nature of an audience is a situational factor that is outside the control of the auditor.

Explanation for Choice D:

The history of previous encounters is a situational factor that is outside the control of the auditor.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 80

An internal audit team recently completed an audit of the company's compliance with its lease versus purchase policy concerning company automobiles. The audit report noted that the basis for several decisions to lease rather than purchase automobiles had not been documented and was not auditable. The report contained a recommendation that operating management ensure that such lease agreements not be executed without proper documentation of the basis for the decision to lease rather than buy. The internal auditors are about to perform follow-up work on this audit report.

Assume that senior management has decided to accept the risk involved in failure to document the basis for lease-versus-purchase decisions involving company automobiles. In such a case, what would be the auditors' reporting obligation?

- A. The auditors should inform the external auditor and any responsible regulatory agency that no action has been taken on the finding in question.
- B. The auditors have no further reporting responsibility.
- C. The auditors should issue a follow-up report to management clearly stating the rationale for the recommendation that the basis for lease-versus purchase decisions be properly documented.
- D. Management's decision and the auditors' concern should be reported to the company's Board of Directors.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 80

CORRECT ANSWER IS **B** . Its Explanation is

When senior management has assumed such risk, reporting to the board is only required for significant findings. There is no indication that the failure to document several decisions is significant enough to report to the board.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Reporting to anyone outside the organization is not required or appropriate.

Explanation for Choice C:

Senior management has already indicated that it understands and has accepted the related risk.

Explanation for Choice D:

The auditors have no further reporting responsibility.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 81

Which of the following is not a benefit of using an interim report?

- A. An interim report allows information requiring immediate attention to be communicated.
- B. Interim reporting can be conducted on an informal basis.
- C. A formal, written interim report may eliminate the need for a final report.
- D. The time required for writing the final report can be minimized.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 81

CORRECT ANSWER IS **C** . Its Explanation is

Interim reports are written or oral and may be transmitted formally or informally. Use of interim reports to communicate information that requires immediate attention, to communicate a change in engagement scope for the activity under review, or to keep management informed of engagement progress when engagements extend over a long period. The use of interim reports does not diminish or eliminate the need for a final report (PA 2410- 1).

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Improved communications is an advantage.

Explanation for Choice B:

Interim reports may be written or oral and may be transmitted formally or informally (PA 2410-1).

Explanation for Choice D:

The interim report can minimize report writing time.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 82

A recommendation in a final engagement communication should address what attribute?

- A. Condition.
- B. Criteria.
- C. Cause.
- D. Effect.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 82

CORRECT ANSWER IS **C** . Its Explanation is

The recommendations are based on the observations and conclusions of the internal auditor. Any observations and recommendations that are made should be based on four attributes. The recommendation in the final engagement communication is addressed by the cause attribute. The cause attribute states the reason for the difference between the expected and actual conditions (why the difference exists).

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Statement of condition is the factual information that the auditor found during the engagement (what does exist).

Explanation for Choice B:

Criteria are the standards, measures or expectations that will be used making measurement (what should exist).

Explanation for Choice D:

Effect is the risk or exposure that the organization (or others) face as a result of the fact that the actual conditions are different than they should be (impact of the difference).

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 83

The best definition of information identified to achieve an internal auditing engagement's objectives is information that

- A. Is useful and convincing.
- B. Is useful and reliable.
- C. Provides an absolute basis for engagement conclusions.
- D. Provides a sound basis for engagement conclusions.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 83

CORRECT ANSWER IS **D** . Its Explanation is

Information should be collected on all matters related to the engagement objectives and scope of work. The information collected by the internal auditor should be sufficient, reliable, relevant, and useful to provide a sound basis for engagement observations, conclusions, and recommendations.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Information has to also be sufficient, reliable, and relevant.

Explanation for Choice B:

Information has to also be relevant and sufficient.

Explanation for Choice C:

There is never an absolute basis for engagement conclusions. The internal auditor cannot have perfect knowledge.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 84

An audit of accounts payable found that the individuals responsible for maintaining the vendor master file could also enter vendor invoices into the accounts payable system. During the exit conference, management agreed to correct this problem. When performing a follow-up engagement of accounts payable, the auditor should expect to find that management had

- A. Modified the accounts payable system to prevent individuals who maintained the vendor master file from entering invoices.
- B. Compared the vendor and employee master files to determine if any unauthorized vendors had been added to the vendor master file.
- C. Transferred the individuals who maintained the vendor master file to another department to ensure responsibilities were appropriately segregated.
- D. Modified the access control system to prevent employees from both entering invoices and approving payments.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 84

CORRECT ANSWER IS **A** . Its Explanation is

Segregation of duties is one method to enhance control. This means that different persons should authorize transactions, record (account for) transactions, and have custody of assets. Individuals who maintain the list of authorized vendors (the vendor master file) are in a position to perpetrate and conceal fraud if they also perform the accounting function for accounts payable. Hence, these functions should be separated.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Comparing the vendor and employee master files would detect the presence of an employee on the vendor list, but it still does not prevent the addition of another unauthorized vendor from being added.

Explanation for Choice C:

Transferring employees will not resolve the control issue.

Explanation for Choice D:

This change would still not solve the problem.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 85

An internal auditing department recently completed an operational audit of the accounts payable function. If a summary report were issued in conjunction with the final report, who would most likely receive the summary report only?

- A. Audit committee of the board of directors.
- B. Accounts payable department manager.
- C. External auditor.
- D. Controller.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 85

CORRECT ANSWER IS **A** . Its Explanation is

Summary reports highlighting audit results may be appropriate for levels of management above the head of the audited unit.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

The accounts payable department manager would be best served by receiving a copy of the full final audit report.

Explanation for Choice C:

The external auditor would receive a copy of the full report.

Explanation for Choice D:

The controller, like the accounts payable department manager, would need a copy of the full final report so that details of deficiencies are known and audit recommendations may be implemented.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 86

The primary reason for having written formal audit reports is to

- A. Document the corrective actions required of senior management.
- B. Provide a formal means by which the external auditor assesses potential reliance on the internal audit department.
- C. Record observations and recommended courses of action.
- D. Provide an opportunity for auditee response.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 86

CORRECT ANSWER IS **C** . Its Explanation is

Audit reports should present the purpose, scope, and results of an audit.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Internal auditors make recommendations; they do not submit requirements.

Explanation for Choice B:

Where appropriate, external auditors would review work papers to accomplish this end.

Explanation for Choice D:

An auditee should have an opportunity to respond before the report is written.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 87

The following information is extracted from a draft of an engagement communication prepared upon the completion of an engagement to review the inventory warehousing procedures for a division.

Observations and Recommendations

We performed extensive tests of inventory record keeping and quantities on hand. Based on our tests, we have concluded that the division carries a large quantity of excess inventory, particularly in the area of component parts. We expect this is due to the conservatism of local management that does not want to risk shutting down production if the goods are not on hand. However, as noted earlier in this engagement communication, the excess inventory has led to a higher-than-average level of obsolete inventory write-downs at this division. We recommend that production forecasts be established, along with lead times for various products, and used in conjunction with economic order quantity concepts to order and maintain appropriate inventory levels.

A major deficiency in the paragraph related to the completeness of the engagement communication is

- A. The recommendations are not required and are not appropriate given the nature of the problem identified.
- B. It does not adequately describe the potential effect of the conditions noted.
- C. There is no indication of the potential cause of the problem.
- D. It does not contain criteria by which the concept of "excessive inventory" is judged.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 87

CORRECT ANSWER IS **D** . Its Explanation is

Any observations and recommendations that are made should be based on the attributes, including criteria, condition, cause and effect. The internal auditor in paragraph #5 does not discuss the criteria of what should exist.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Engagement communications should include recommendations for potential improvements, acknowledgments of satisfactory performance, and corrective actions.

Explanation for Choice B:

The report does discuss the effect of the conditions noted. The internal auditor noted that the excess inventory has led to a higher-than-average level of obsolete inventory write-downs at this division.

Explanation for Choice C:

The cause of the problem is due to the conservatism of local management.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 88

Even though an internal auditor referred a case of potential fraud to the security department, the suspected perpetrator continued to defraud the organization until discovered by a line manager two years later. The internal auditor

- A. Should have periodically checked the status of the case with the security department.
- B. Should have conducted a fraud investigation.
- C. Took appropriate action.
- D. Should have discharged the perpetrator.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 88

CORRECT ANSWER IS **A** . Its Explanation is

The internal auditors' responsibility does not end with informing the security department. The internal auditor should periodically check the status of the case.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

The security department would likely conduct the fraud investigation.

Explanation for Choice C:

The internal auditor should have conducted follow up. The internal auditors' responsibility does not end with informing the security department.

Explanation for Choice D:

The internal auditor would have no authority to discharge the perpetrator.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 89

The internal audit activity customarily has a dual relationship with management and the audit committee. This means that

- A. The accuracy of engagement communications should be verified with management, and the internal audit activity should then report to management and the audit committee.
- B. Management should help the internal audit activity by revising and forwarding engagement communications to the audit committee.
- C. The internal audit activity should report directly to the audit committee, without corroborating engagement communications with management.
- D. Ideally, the internal audit activity works under the audit committee but reports to the chief operating officer on all engagements relating to operations.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 89

CORRECT ANSWER IS **A** . Its Explanation is

Internal auditors should first discuss conclusions and recommendations with management so management is able to verify the accuracy of the engagement communications. Final engagement communications would then be sent to the audit committee.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Engagement communications would go direct to the audit committee.

Explanation for Choice C:

Engagements communications should also be communicated with management.

Explanation for Choice D:

Ideally, the CAE would administratively report to the CEO or high enough officer to maintain independence, and functionally to the audit committee or some other appropriate governing board. Under the ideal situation, all engagement communications are sent to the audit committee as well.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 90

A final communication issued by an internal auditor following an assurance engagement should contain an expression of opinion when

- A. The area of the engagement is the financial statements.
- B. A full-scope engagement has been conducted in an area.
- C. An opinion will improve communications with the readers of the communication.
- D. The internal auditors' work is to be used by external auditors.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 90

CORRECT ANSWER IS **C** . Its Explanation is

Final communication of engagement results must, where appropriate, contain internal auditors' overall opinion and/or conclusions (Standard 2410.A1). If the expression of an opinion would help to improve communication then it should be given.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The area of the engagement is irrelevant as regards determining whether or not an expression of opinion is required.

Explanation for Choice B:

An overall opinion is not required in all circumstances.

Explanation for Choice D:

The use or otherwise of the internal auditor's work by external auditors is also irrelevant as regards determining whether or not an expression of opinion is required. It is the responsibility of external auditors to form their own opinion.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 91

Recommendations in engagement communications may, or may not, actually be implemented. Which of the following best describes internal auditing's role in follow-up on engagement recommendations? Internal auditing

- A. Should request that independent auditors follow up on engagement recommendations.
- B. Has no role; follow-up is management's responsibility.
- C. Should follow up to ascertain that appropriate action is taken on engagement recommendations.
- D. Should be charged with the responsibility for implementing engagement recommendations.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 91

CORRECT ANSWER IS **C** . Its Explanation is

The CAE must establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action (Standard 2500.A1).

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

The external auditor should not assume follow-up.

Explanation for Choice B:

The internal auditor has a responsibility to conduct follow-up.

Explanation for Choice D:

Internal auditors do not have the authority to implement engagement recommendations, nor should they. This action would impair the IAA's independence.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 92

Recommendations should be included in audit report to

- A. Guarantee that audit findings are addressed, regardless of the cost.
- B. Ensure that problems are resolved in the manner suggested by the auditor.
- C. Minimize the amount of time required to correct audit findings.
- D. Provide management with options for addressing audit findings.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 92

CORRECT ANSWER IS **D** . Its Explanation is

The internal auditor may communicate recommendations for improvements, acknowledgements of satisfactory performance, and corrective actions. Recommendations are based on the internal auditor's observations and conclusions. They call for action to correct existing conditions or improve operations and may suggest approaches to correcting or enhancing performance as a guide for management in achieving desired results. Recommendations can be general or specific. For example, under some circumstances, the internal auditor may recommend a general course of action and specific suggestions for implementation. In other circumstances, the internal auditor may suggest further investigation or study (PA 2410-1).

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Management may decide that the cost of taking corrective action is not cost beneficial. In this case, management assumes the risk of not taking action.

Explanation for Choice B:

Management, not by the auditor, resolves problems.

Explanation for Choice C:

The recommendations may, or may not minimize the amount of time required to correct audit findings.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 93

An internal audit report addressing a payroll department's weaknesses along with recommended corrective actions would be most useful to the company's

- A. Payroll department manager.
- B. Treasurer.
- C. Audit committee of the board of directors.
- D. President.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 93

CORRECT ANSWER IS **A** . Its Explanation is

Control weaknesses over the payroll function would be most useful to the payroll department manager because this is the individual who is directly responsible for this department.

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

Control weaknesses in a company's payroll department would not be most useful to the treasurer because the treasurer is not responsible for taking corrective action for weaknesses in such a department.

Explanation for Choice C:

The audit committee of the board of directors would not have a direct interest in a report dealing with weaknesses over the payroll function and thus, such a report would not be most useful to such individuals.

Explanation for Choice D:

A company's president is responsible for the overall operations of the company. Accordingly, weaknesses in controls over payroll would not be most useful to the president.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 94

It is most likely that the final engagement communication regarding supply activities of a division will be circulated to

- A. The lowest level managers with sufficient authority to take action on engagement recommendations because it is their responsibility.
- B. The mid and lower level engagement client personnel of the division because they are the ones most affected.
- C. The organization's external auditors because they will need the information in performing their own engagement.
- D. The highest level of managers because they should be kept informed.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 94

CORRECT ANSWER IS **A** . Its Explanation is

The CAE distributes the final engagement communication to the management of the audited activity and to those members of the organization who can ensure engagement results are given due consideration and take corrective action or ensure that corrective action is taken. Where appropriate, the CAE may send a summary communication to higher-level members in the organization. Where required by the internal audit charter or organizational policy, the CAE also communicates to other interested or affected parties, such as external auditors and the board (PA 2440-1.4).

INCORRECT CHOICES EXPLANATION

Explanation for Choice B:

The mid and lower level personnel are not in a position of authority to act on the recommendations.

Explanation for Choice C:

External auditors may receive a copy of the final engagement communications, but this is not an absolute.

Explanation for Choice D:

The highest level of managers would more likely receive only a summary report.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 95

Which of the following combinations of participants is most appropriate to attend an exit interview?

- A. Staff internal auditors who conducted the fieldwork and operating personnel in charge of the daily performance of the activity or function reviewed.
- B. The responsible internal auditor and representatives from management who are knowledgeable about detailed operations and who can authorize implementation of corrective action.
- C. Staff auditors who conducted the fieldwork and the executive in charge of the activity or function reviewed.
- D. The chief audit executive and the executive in charge of the activity or function reviewed.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 95

CORRECT ANSWER IS **B** . Its Explanation is

The internal auditor discuss conclusions and recommendations with the appropriate levels of management before the CAE issues the final communications. The level of participants in the discussions and reviews vary by organization and nature of the report; they generally include those individuals who are knowledgeable of detailed operations and those who can authorize the implementation of corrective action (PA 2440-1).

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Staff internal auditors and operating personnel do not have the proper authority.

Explanation for Choice C:

Staff auditors would not have the proper authority.

Explanation for Choice D:

The CAE and the executive in charge of the activity may not be completely knowledgeable of detailed operations.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 96

What is the most likely reason for a chief audit executive (CAE) to send copies of an audit report, citing significant internal control weaknesses, to the audit committee and the external auditor?

- A. The audit committee and external auditor can be expected to take corrective action on the findings.
- B. Some regulatory agencies require such a distribution.
- C. The audit committee and external auditor are normally sent copies of all internal audit reports.
- D. The activities of the audit committee and external auditor may be affected because of the potential for misstated financial statements.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 96

CORRECT ANSWER IS **D** . Its Explanation is

Reports may also be distributed to other interested or affected parties such as external auditors and the board. The potential for misstated financial statements created by the internal control deficiencies should be of interest to the external auditors and the audit committee of the board of directors.

INCORRECT CHOICES EXPLANATION

Explanation for Choice A:

Operating management takes corrective action.

Explanation for Choice B:

There is no such requirement.

Explanation for Choice C:

Normal distribution is to department heads of units audited and others in a position to take corrective action or ensure that corrective action is taken.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 97

According to IIA guidance, when an engagement final communication contains a significant error, the chief audit executive is required to do which of the following?

- A. Communicate corrected information to all individuals who received the original communication.
- B. Communicate corrected information to all those who might have relied on the original communication.
- C. Issue a written report to the audit committee and senior management.
- D. Issue a written report to individuals who can ensure that engagement results are given due consideration.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 97

CORRECT ANSWER IS **A** . Its Explanation is

According to **Standard 2421: Errors and Omissions**, "If a final communication contains a significant error or omission, the chief audit executive must communicate corrected information to all parties who received the original communication."

INCORRECT CHOICES EXPLANATION

Explanation for B:

The CAE should report corrected information only to parties who received the original communication.

Explanation for C:

The CAE should report corrected information only to parties who received the original communication.

Explanation for D:

The CAE should report corrected information only to parties who received the original communication.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 98

Recommendations should be included in audit reports to

- A. Ensure that problems are resolved in the manner suggested by the auditor.
- B. Guarantee that audit findings are addressed, regardless of the cost.
- C. Minimize the amount of time required to correct audit findings.
- D. Provide management with options for addressing audit findings.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 98

CORRECT ANSWER IS **D** . Its Explanation is

The internal auditor may communicate recommendations for improvements, acknowledgements of satisfactory performance, and corrective actions. Recommendations are based on the internal auditor's observations and conclusions. They call for action to correct existing conditions or improve operations and may suggest approaches to correcting or enhancing performance as a guide for management in achieving desired results. Recommendations can be general or specific. For example, under some circumstances, the internal auditor may recommend a general course of action and specific suggestions for implementation. In other circumstances, the internal auditor may suggest further investigation or study (PA 2410-1).

INCORRECT CHOICES EXPLANATION

Explanation for A:

Management, not by the auditor, resolves problems.

Explanation for B:

Management may decide that the cost of taking corrective action is not cost beneficial. In this case, management assumes the risk of not taking action.

Explanation for C:

The recommendations may, or may not minimize the amount of time required to correct audit findings.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 99

When faced with an imposed scope limitation, the chief audit executive (CAE) should

- A. Increase the frequency of auditing the activity in question.
- B. Assign more experienced personnel to the engagement.
- C. Delay the audit until the scope limitation is removed.
- D. Communicate the potential effects of the scope limitation to the audit committee of the board of directors.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 99

CORRECT ANSWER IS **D** . Its Explanation is

The scope limitation and its potential effects should be communicated to the audit committee of the board of directors.

INCORRECT CHOICES EXPLANATION

Explanation for A:

A scope limitation would not necessarily cause the need for more frequent audits.

Explanation for B:

A scope limitation would not necessarily cause the need for more experienced personnel.

Explanation for C:

The audit may be conducted under a scope limitation.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 100

Which of the following would not be included in the statement of scope in an engagement final communication?

- A. Engagement objectives.
- B. Nature and extent of the engagement work performed.
- C. Related activities excluded from the review.
- D. Period covered by the review.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 100

CORRECT ANSWER IS **A** . Its Explanation is

Engagement objectives are included in the Purpose Statement of the report.

INCORRECT CHOICES EXPLANATION

Explanation for B:

Scope statements identify the audited activities and may include supportive information such as time period reviewed and related activities not reviewed to delineate the boundaries of the engagement. They may describe the nature and extent of engagement work performed.

Explanation for C:

Scope statements identify the audited activities and may include supportive information such as time period reviewed and related activities not reviewed to delineate the boundaries of the engagement. They may describe the nature and extent of engagement work performed.

Explanation for D:

Scope statements identify the audited activities and may include supportive information such as time period reviewed and related activities not reviewed to delineate the boundaries of the engagement. They may describe the nature and extent of engagement work performed.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 101

To promote a positive image within an organization, a CAE planned to conduct assurance engagements that highlighted potential cost savings. Negative observations were to be omitted from the engagement's final communications. Which action taken by the CAE would be considered a violation of the Standards?

- I. The focus of the audit engagements was changed without modifying the charter or consulting the audit committee.
- II. Negative observations were omitted from the engagement final communications.
- III. Cost savings recommendations were highlighted in the engagement final communications.

- A. I and III only.
- B. II and III only.
- C. I only.
- D. I and II only.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 101

CORRECT ANSWER IS **D** . Its Explanation is

I, II. Correct. The CAE dramatically changed the nature of the audit activity without consulting the audit committee or modifying the internal audit charter. Standard 1000 states that the purpose, authority, and responsibility of the internal audit activity must be formally defined in a charter. Standard 2400 requires that internal auditors communicate the engagement results. Standard 2420 states that communications must be accurate, objective, clear, concise, constructive, complete, and timely. The Interpretation further states that complete communications are lacking nothing that is essential to the target audience and include all significant and relevant information and observations to support recommendations and conclusions.

III. Incorrect. Highlighting potential cost savings is appropriate for an engagement final communication.

INCORRECT CHOICES EXPLANATION

Explanation for A:

See the correct answer for an explanation.

Explanation for B:

See the correct answer for an explanation.

Explanation for C:

See the correct answer for an explanation.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 102

A follow-up review found that a significant internal control weakness had not been corrected. The CAE discussed this matter with senior management and was informed of management's willingness to accept the risk. The CAE should:

- A. Assess the reasons that senior management decided to accept the risk and inform the board of senior management's decision.
- B. Inform senior management that the weakness must be corrected and schedule another follow-up review.
- C. Do nothing further because management is responsible for deciding the appropriate action to be taken in response to reported engagement observations and recommendations.
- D. Initiate a fraud investigation to determine if employees had taken advantage of the internal control weakness.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 102

CORRECT ANSWER IS **A** . Its Explanation is

According to *Standard 2600*, “When the chief audit executive believes that senior management has accepted a level of residual risk that may be unacceptable to the organization, the chief audit executive should discuss the matter with senior management. If the decision regarding residual risk is not resolved, the chief audit executive and senior management should report the matter to the board for resolution.”

INCORRECT CHOICES EXPLANATION

Explanation for B:

The CAE has no authority to require corrective action.

Explanation for C:

The CAE and senior management should report the matter to the board if the CAE believes that the residual risk may be unacceptable.

Explanation for D:

The facts do not indicate that fraud took place.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 103

During a consulting engagement involving the development of a new accounts payable system, an internal auditor identified a control weakness. Although the weakness was reported to the manager of the systems development project, the manager decided to accept the risk because, in the manager's opinion, the risk was not significant. Six months after implementation of the new system, the disbursements process was audited by another internal auditor who determined that the control weakness had impacted payment processing. The auditor reviewing the disbursements process should do which of the following?

- A. Report the control weakness to management and the audit committee.
- B. Request that the manager of the systems development project fix the system.
- C. Discuss the control weakness with the manager of the accounting system, but do not report the finding.
- D. Disregard the control weakness because management previously decided to accept the risk.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 103

CORRECT ANSWER IS **A** . Its Explanation is

Weaknesses in the internal control system that management has previously accepted need to be reported to management and the audit committee when the situation has change. That has happened in this case because the risk is now impacting the payment processing.

INCORRECT CHOICES EXPLANATION

Explanation for B:

When weaknesses in the internal control system are identified, it is not the role of the IAA to request the manager to fix them.

Explanation for C:

This control weakness needs to be reported to management and the audit committee.

Explanation for D:

This control weakness needs to be reported to management and the audit committee.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 104

Which of the following is not a responsibility of the CAE?

- A. To oversee the establishment, administration, and assessment of the organization's system of risk management processes.
- B. To communicate the internal audit activity's plans and resource requirements to senior management and the board for review and approval.
- C. To coordinate with other internal and external providers of audit and consulting services to ensure proper coverage and minimize duplication.
- D. To follow up on whether appropriate management actions have been taken on significant reported risks.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 104

CORRECT ANSWER IS **A** . Its Explanation is

Practice Advisory 2120-1 states that this is the role of senior management and the board, not the CAE.

INCORRECT CHOICES EXPLANATION

Explanation for B:

This is a responsibility of the CAE, according to Standard 2020.

Explanation for C:

This is a responsibility of the CAE, according to Standard 2050.

Explanation for D:

This is a responsibility of the CAE, according to Standard 2500.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 105

Which of the following statements, if true, would justify a chief audit executive's decision not to report certain control concerns regarding derivatives trading in a report to the audit committee?

- A. The amounts of trading and the potential risks associated with the derivatives trading are not material to the overall organization.
- B. Management plans to initiate corrective action.
- C. Derivatives are complex, and the auditor should rely on management's analysis of the extent of the problem.
- D. The board has a separate committee to make recommendations on trading issues.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 105

CORRECT ANSWER IS **A** . Its Explanation is

If the risk related to the derivatives trading is not material, the CAE may choose not to report this risk to the audit committee.

INCORRECT CHOICES EXPLANATION

Explanation for B:

If the CAE feels that there are unaddressed residual risks, they should report them to the audit committee, even if there are corrective actions that are intended to be initiated.

Explanation for C:

When there are residual risk items that that may be material and are not addressed, the CAE should report this residual risk to the audit committee.

Explanation for D:

If the CAE feels that there are unaddressed residual risks, they should report them to the audit committee, even if there is a separate committee making recommendations about that issue.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 106

Which of the following statements best describes the internal audit activity's responsibility for follow-up activities related to a previous engagement?

- A. Internal auditors should determine if corrective action has been taken and is achieving the desired results or if management has assumed the risk of not taking the corrective action.
- B. None of the above.
- C. The CAE is responsible for scheduling follow-up activities only if directed to do so by senior management or the audit committee. Otherwise, follow-up is entirely discretionary.
- D. Internal auditors should determine if management has initiated corrective action, but they have no responsibility to determine if the action is achieving the desired results. That determination is management's responsibility.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 106

CORRECT ANSWER IS **A** . Its Explanation is

This is stated in Practice Advisory 2500.A1-1.

INCORRECT CHOICES EXPLANATION

Explanation for B:

See the correct answer for an explanation.

Explanation for C:

Standard 2500.A1 states that the CAE must establish a follow-up process. It is not dependent on directives of either senior management or the audit committee.

Explanation for D:

This contradicts answer “a” and Practice Advisory 2500.A1-1.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 107

The internal audit activity's (IAA's) responsibility to follow up on reported audit findings should be defined in which of the following?

- A. The IAA's written charter.
- B. The purpose statement within the applicable audit report.
- C. The engagement memo issued prior to each audit assignment.
- D. The mission statement of the audit committee.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 107

CORRECT ANSWER IS **A** . Its Explanation is

The IAA's responsibility to follow up on reported audit findings should be defined in the internal audit charter.

INCORRECT CHOICES EXPLANATION

Explanation for B:

The IAA's responsibility to follow up on reported audit findings should be defined in the internal audit charter.

Explanation for C:

The IAA's responsibility to follow up on reported audit findings should be defined in the internal audit charter.

Explanation for D:

The IAA's responsibility to follow up on reported audit findings should be defined in the internal audit charter.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 108

Management and the board of directors are responsible for following up on observations and recommendations made by the external auditors. What role, if any, should the internal audit activity have in this process?

- A. The internal audit activity should only become involved if the CAE has sufficient evidence that the follow-up is not occurring.
- B. The internal audit activity should become involved only if specifically requested by management or the board of directors.
- C. The internal audit activity should have no role in this process to ensure independence.
- D. The internal audit activity should establish a monitoring process to review the adequacy and effectiveness of management's follow-up actions.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 108

CORRECT ANSWER IS **D** . Its Explanation is

A CAE should establish a follow-up process to monitor the adequacy, effectiveness, and timeliness of actions taken by management on reported engagement observations and recommendations, including those made by the external auditors and others.

INCORRECT CHOICES EXPLANATION

Explanation for A:

See the correct answer for an explanation.

Explanation for B:

See the correct answer for an explanation.

Explanation for C:

See the correct answer for an explanation.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 109

If a client has responded to audit observations before the engagement final communication has been issued, which of the following is true regarding the responses?

- A. They do not need to be signed.
- B. They do not need to be included in the audit file.
- C. They should be tested immediately for accuracy.
- D. They should be reflected in the engagement final communication.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 109

CORRECT ANSWER IS **D** . Its Explanation is

When the client has already begun implementing recommendation before the final engagement communication is issued, this information should be included in the report.

INCORRECT CHOICES EXPLANATION

Explanation for A:

The implementation made by the engagement client does not need to be signed.

Explanation for B:

The implementation made by the engagement client does not need to be included in the audit file.

Explanation for C:

The implementation made by the engagement client will not be tested at this time. It will be tested as part of the follow-up engagement. However, the fact that they have implemented things should be included in the final report.

Section D – Communicating Engagement Results and Monitoring Progress

MULTIPLE CHOICE QUESTION NO. 110

An internal auditor is developing a questionnaire for company employees that includes several rating scales. Which of the following statements is not correct regarding the use of rating scales?

- A. A range of choices gives employees the ability to express the strength of their feelings about a particular topic.
- B. Rating scales lend themselves to creating charts and graphs.
- C. The auditor will know exactly how employees feel after compiling the results of the survey.
- D. Employees may have a hard time distinguishing between “agree” and “strongly agree” when taking the questionnaire.

Section D – Communicating Engagement Results and Monitoring Progress

ANSWER TO QUESTION NO. 110

CORRECT ANSWER IS **C** . Its Explanation is

Imprecise word choice when constructing rating scale questions may result in misinterpretation of the question leading to poor data from the survey, and employees may have thoughts that are not captured by a simple rating scale.

INCORRECT CHOICES EXPLANATION

Explanation for A:

See the correct answer for an explanation.

Explanation for B:

See the correct answer for an explanation.

Explanation for D:

See the correct answer for an explanation.

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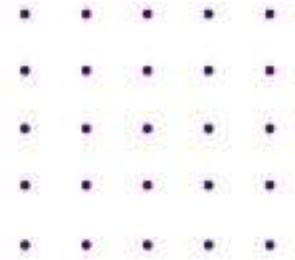
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QUOTES THAT WILL CHANGE YOUR LIFE



QUOTES THAT WILL CHANGE YOUR LIFE

These are the quotes that have made me what I am today. You can also be the one in your Universe:

- We are born in one day. We die in one day. We can change in one day. And we can fall in love in one day Anything can happen in just one day.

The finest of the brains are in an extreme level of slavery. For them, career and job are important than financial freedom and peace of soul. You will be replaced in a day or two when you leave this world for eternal life. Not understanding this point will lead to a dead-end tunnel. Seek certification to change your world, well-being, and, most important yourself.

- Excellence, Creativity, Passion, and Patience are key ingredients to become a Star.
- Get up and Hustle. Chase your dreams. Turn your dreams into reality by showing up every day.

QUOTES THAT WILL CHANGE YOUR LIFE

- Have Confidence. You can do it. You have the capacity and potential to reach the top. Just believe in your abilities and chase your dream.
- Dream is what seen by an open eye, not with the closed one.
- Dreams don't work unless you do.
- What we learn becomes a part of who we are.
- The right way to start your day is to focus on end goal.
- Sometimes the bad things that happen in our lives put us directly on the path to the best things that will ever happen to us.
- A creative man is motivated by the desire to achieve, not by the desire to beat others.
- Twenty years from now you will be more disappointed by the things that you didn't do than by the ones you did do. So throw off the bowlines. Sail away from the safe harbor. Catch the trade winds in your sails. Explore. Dream. Discover.

QUOTES THAT WILL CHANGE YOUR LIFE

- It does not matter how slow you go. So long as you don't stop.
- It is never too late to begin.
- If it scares you, it might be a good thing to try.
- There is only you and your camera. The limitations in your photography are in yourself, for what we see is what we are.
- Creativity is Intelligence having fun.
- All progress takes place out of comfort zone, so when are you starting.
- Everything you have ever wanted is on the other side of fear.
- When everything seems to be going against you, remember that the airplane takes off against the wind, not with it.

QUOTES THAT WILL CHANGE YOUR LIFE

- Unexpected kindness is the most powerful, least costly, and most underrated agent of human change.
- Sometimes courage is the quiet voice at the end of the day saying I will try again tomorrow.
- Sometimes you win, sometimes you learn.
- Do something today that your future self will thank you for.
- The past has no power over the present moment. So forget about your failures and start a new day.
- Most of the important things in the world have been accomplished by people who have kept on trying when there seemed to be no help at all.
- Your imagination is everything. It is the preview of life's coming attractions. Only those who believe anything is possible can achieve things most would consider impossible.
- Don't let the noise of others' opinions drown out your own inner voice.
- Have the courage to follow your heart and intuition. They somehow already know what you truly want to become. Everything else is secondary.

QUOTES THAT WILL CHANGE YOUR LIFE

- Your time is limited, so don't waste it living someone else's life.
- Remembering that you are going to die is the best way I know to avoid the trap of thinking you have something to lose. You are already naked. There is no reason not to follow your heart.
- Your work is going to fill large part of your life and the only way to be truly satisfied is to do what you believe is great work. The only way to do great work is to love what you do. If you haven't found it yet, keep looking. Don't settle. As with all matters of the heart, you will know when you find it.
- Success doesn't come from what you do occasionally. It comes from what you do consistently.
- If opportunity doesn't knock, build a door.
- The things you regret most in life are the risks you didn't take.
- Every successful person was once an unknown person that refused to give up on their dream.
- Life is too short to be working for someone else's dream.

QUOTES THAT WILL CHANGE YOUR LIFE

- It always seems impossible until it's done.
- Innovation distinguishes between a leader and a follower.
- Success is not final; failure is not fatal. It is the courage to continue that counts.
- Every problem is a gift. Without problems, we would not grow.
- There is no shortage of remarkable ideas, what's missing is the will to execute them.
- Forget past mistakes. Forget failures. Forget everything except what you are going to do now and do it.
- Many of life's failure are people who did not realize how close they were to success when they gave up.
- If something is important enough, or you believe something is important enough, even if you are scared, you will keep going.

QUOTES THAT WILL CHANGE YOUR LIFE

- The best way to predict the future is to create it.
- The only strategy that is guaranteed to fail is not taking risks.
- Only those who will risk going too far can possibly find out how far one can go.
- Don't waste words on people who deserve your silence. Sometimes the most powerful thing you can say is nothing at all.

ABOUT THE AUTHOR

Muhammad Zain has passed Uniform Certified Public Accountant (CPA) exams from the American Institute of Certified Public Accountants (AICPA), US in February 2018, Certified Management Accountant (CMA) exams from Institute of Management Accountants (IMA), US and Certified Internal Auditor (CIA) exams from Institute of Internal Auditors (IIA), US in March 2014. He completed his Masters of Business Administration (MBA) in March 2010 from the University of Karachi, Pakistan. He earned his Bachelors of Commerce (BCom) from the same University in November 2007.

He has working experience of sixteen years, which includes five years of Public Accounting experience of working in EY Ford Rhodes, Pakistan – a member firm of Ernst & Young Global Limited (big4), and nine years of working experience in Industry.

He founded Zain Academy on 27 February 2017 with the mission "Knowledge for ALL" and the objective to "disseminate education for all candidates who wish to change the landscape of our working environment, believe in continuous education, and strive for the best." The idea is not to live forever but to create something that will.

Many candidates worldwide have taken his help, motivation, and guidance in attaining their true potential.

Readers are welcomed to contact him for any assistance in any part of CIA, CMA, CPA, or seek consultancy on any standard of IFRS, GAAP, ISA, and GAAS. Furthermore, visit the Zain Academy's YouTube channel for informative videos on CIA, CMA, CPA, IFRS, and upcoming publications.



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