WT 8 (Ch. 16 – Internal Audit and Ch. 17 – Due Diligence, Investigation & Forensic Accounting)

Marks: 25

Time: 45 Minutes

Instructions: **Part A comprises of MCQ.**

Part B comprises of descriptive questions.

Part – A (Multiple Choice Questions)

Karma Ltd. got incorporated in 1980s as a private limited company and started its business into two segments – printing and construction. The two business activities were completely different but those were managed very well and the company grew significantly over a period of time. In year 2001, the company got converted into a public company and in 2008, the company also got listed on Bombay Stock Exchange.

The turnover of the company was increasing, however, the margins were not increasing as per the expectations of the management and the management analysed this aspect and realized that the margins were not so high in case of printing segment.

The company decided to focus more on construction business and included infrastructure in its line of business. This was also because of the fact that the government policies were favourable towards the infrastructure sector. Eventually, the company decided to sell its printing segment in 2015.

The new investor (i.e. buyer) for the printing segment carried out a due diligence of the printing business involving various aspects and the company sold this segment in January 2016.

Since the business of the company included infrastructure and it involved transactions with government officials also, the management suspected certain suspicious transactions for which it decided to carry out a forensic audit in the financial year 2016-17. During the audit, certain transactions were identified highly risky, on which the management discussed and set up certain new processes and stringent controls so that the business can function in an efficient manner.

For the financial year ended 31 March 2024, a due diligence was done for the company, which impacted the company significantly in terms of its reputation and business. The company lost some significant contracts during the process of investigation itself.

At the time of due diligence review, the reviewer assessed the business feasibility also so as to assess whether the current business would be more beneficial in future or not. The management of Karma Ltd. did not understand this perspective. The management argued that the reviewer has no powers to assess the business feasibility, as the company was running a profitable business from many years.

The company had various litigations going on including those related to matter of taxation. The company had taken consultations in respect of those litigations from professionals and renowned legal/tax consultants. The reviewer for due diligence reviewed these consultation documents and also asked for the documents related to these matters. Further, he also suggested that the decision taken by the company in some matters was not correct.

At the time of investigation, the reviewer asked about the background of the promoters of the company. The management explained that there was no need for this investigation. Further, the management explained that the company has already gone through the processes of due diligence and forensic audit in the previous years and there was no doubt raised on promoters of the company. So, the background of promoters cannot be shared with the reviewer.

In the light of the above-mentioned facts, you are required to answer the following questions:

Q.1 **The management argued that the reviewer has no powers to assess the business feasibility, as the company has been running a profitable business from many years. Which of the following statement should be correct?** **2**

(a) The contention of the management was correct.

(b) Reviewer was correct, as due diligence covers assessment of business feasibility as well.

(c) Reviewer was correct as due diligence covers assessment of business feasibility as well, however, as the company was doing this business for decades it should not have been carried out by the reviewer.

(d) Management was correct; however, it should have discussed the same with the investor as part of the sale contract.

Q.2 **The due diligence reviewer was given audited financial statement of the company for his financial review for the year ended March 2024. However, the reviewer asked for financial statements for the year ended 31 March 2023, which was already audited by the statutory auditors of the company and the management of the company declined this request.** **2**

(a) The management is correct.

(b) Reviewer can ask for documents even for the period for which audit is completed.

(c) Reviewer can ask for financial statements for the period for which audit is completed but he cannot give any statement on them. He can collect the same for his documentation purpose only as per the requirements of the auditing standards.

(d) Reviewer has no right to review the financial statements of the period other than the period under review.

Q.3 **The reviewer for due diligence reviewed the consultation documents pertaining to various litigations going on including those related to matter of taxation and also asked for the documents related to these matters. Further, he also suggested that the decision taken by the company in some matters was not correct.** **2**

(a) The reviewer needs to have independent assessment of legal/tax cases and any outcome needs to be discussed with the management.

(b) The company should not have provided the documents as those are confidential.

(c) The reviewer can study the tax consultation document but cannot give his opinion as the company already took the opinion from professional consultant.

(d) Tax and legal matters are not a part of review of due diligence exercise.

Q.4 The management may refuse to share the details of promoters. Comment on this. **2**

(a) Since the company has already went through due diligence and forensic audit in the previous years, the management may refuse to provide promoters details to the reviewer.

(b) As the background of promoters has no bearing on the financials of the company, the reviewer should not ask for the details of promoters and the management may refuse to provide the same.

(c) Since the company went through processes of forensic audit in the past, and set up new processes and internal controls, the reviewer should not investigate into the background of promoters.

(d) The contention of the management is not correct.

Part B (Descriptive Questions)

Q. No. 1 is Compulsory. Attempt Any three from the rest.

Q.1 One of the independent directors sought information regarding the appointment of internal auditors for following Group Companies in accordance with the Companies Act, 2013 of which certain Financial Information are given below: **5**

Figures are in (₹) crore and correspond to the previous year.

Name	Nature	Equity Share Capital	Turnover	Loan from Bank and PFI	Public Deposits
AADI Ltd.	Listed	100	190	50	24
AJIT Ltd.	Unlisted Public	45	135	-	35
NEMI Ltd.	Unlisted Private	250	190	80	-

You are required to evaluate the requirements of the Companies Act, 2013 regarding the appointment of internal Auditors for the Group Companies. Discuss

Q.2 A Ltd. who is one of the leading manufacturer of kids clothing is interested to acquire B Ltd. B Ltd. is currently a manufacturer of women' clothing. As a professional consultant in due diligence and valuation, A Ltd. entrusted you to value B Ltd. The valuation of B Ltd. is dependent on future maintainable sales. Discuss the factors you would consider in assessing the future maintainable turnover of B Ltd? **4**

Q.3 Mr. Clean who proposes to buy the proprietary business of Mr. Perfect, engages you as investigating accountant. Specify the areas which you will cover in your investigation. **4**

Q.4	**X Limited engaged in manufacturing of floor coverings has taken a Product Liability Insurance policy (PLI). Such a policy covers risk of liabilities for damages for bodily injury resulting from sale and distribution of floor coverings by vendors of X Limited's products. The policy is also subject to "claim series" clause. A Claims Series event is as a series of two or more claims arising from one specific common cause which are attributable to the same fault in design or manufacture of products or to the supply of the same products showing the same defect. A claim series event is deemed to be one claim under the terms & conditions of PLI policy.** **The company has been asked to shell out damages of ₹ 5 crore due to supply of faulty products to one of its vendors. The vendor had sold floor coverings to a 5-star hotel which has alleged that harmful chemicals used in dyeing of floor coverings have resulted in skin ailments to some of its guests.** **Being in capacity of forensic accountant Professional appointed by insurance company, what special issues you would keep in mind while dealing with claims involving PLI policy covering such matters?**	**4**
Q.5	**Management is a process by which the affairs of an enterprise are conducted in such a manner that its goals and objectives are attained through optimum utilisation of all available resources, within the legal, social, economic and environmental constraints.** **Explain how internal Audit helps management to achieve organization goals and perform its function in an orderly manner.**	**4**

Instructions for submission of answer sheet

Single PDF of answer sheet is to be e-mail at test.altclasses@gmail.com

Subject line "Final Audit Test – WT 8 (Sep./Oct. 2024 Series) - (*Student Name*)"

Mention the following in the E-mail and answer Sheet:

1. Name:
2. Mobile No.:
3. Test: Final Audit – WT 8
4. Order Details/Serial Key: