

Suggested Answers and Marking Scheme

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

Marks: 27

Time: 50 Minutes

Instructions: Part A comprises of MCQ.

Part B Comprises of descriptive questions.

Part – A (Multiple Choice Questions)

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|-----|---|---|
| Q.1 | (b) Reviewer was correct, as due diligence covers assessment of business feasibility as well. | 2 |
| Q.2 | (b) Reviewer can ask for documents even for the period for which audit is completed. | 2 |
| Q.3 | (a) The reviewer needs to have independent assessment of legal/tax cases and any outcome needs to be discussed with the management. | 2 |
| Q.4 | (d) The contention of the management is not correct. | 2 |

Part B (Descriptive Questions)

Q. No. 1 is Compulsory. Attempt ANY TWO from the rest.

- Q.1 (a) **Applicability of Internal Audit:** www.altclasses.in
- As per Sec. 138 of the Companies Act, 2013 read with Rule 13 of Companies (Accounts) Rules, 2014, following class of companies shall be required to appoint an internal auditor or a firm of internal auditors, namely:
 - (A) every listed company;
 - (B) every unlisted public company having-
 - (1) paid up share capital of ₹ 50 crores or more during the preceding financial year; or
 - (2) turnover of ₹ 200 crores or more during the preceding financial year; or
 - (3) outstanding loans or borrowings from banks or public financial institutions exceeding ₹ 100 crores or more at any point of time during the preceding financial year; or
 - (4) outstanding deposits of ₹ 25 crores or more at any point of time during the preceding financial year; and (1 Mark)
 - (C) every private company having-
 - (1) turnover of ₹ 200 crores or more during the preceding financial year; or
 - (2) outstanding loans or borrowings from banks or public financial institutions exceeding ₹ 100 crores or more at any point of time during the preceding financial year. (1 Mark)

- In the given situation, AADI Ltd. is a listed company. As per Sec. 138 of the Companies Act, 2013, every listed company is required to appoint an internal auditor or a firm of internal auditors. Thus, in view of the above, AADI Ltd. is required to appoint an internal auditor.

(1 Mark)

- Further, AJIT Ltd. is unlisted public company. The company is having ₹ 35 crores as public deposits which is exceeding the prescribed limit of ₹ 25 crores. Thus, AJIT Ltd. is required to appoint an internal auditor.

(1 Mark)

- NEMI Ltd. is unlisted private company and having ₹ 250 crore as equity share capital, ₹ 190 crore as turnover and ₹ 80 crore loan from Bank and PFI. All the limits are below the prescribed limit for a private company. Therefore, **NEMI Ltd. is not required to appoint an internal auditor.**

(1 Mark)

(b) **Factors to be considered in assessing future maintainable turnover:**

In assessing the turnover which the business would be able to maintain in the future, the following factors should be taken into account:

- Trend:** Whether in the past, sales have been increasing consistently or they have been fluctuating. A proper study of this phenomenon should be made.
- Marketability:** Is it possible to extend the sales into new markets or that these have been fully exploited? Product wise estimation should be made.
- Political and economic considerations:** Are the policies pursued by the Government likely to promote the extension of the market for goods to other countries? Whether the sales in the home market are likely to increase or decrease as a result of various emerging economic trends?
- Competition:** What is the likely effect on the business if other manufacturers enter the same field or if products which would sell in competition are placed on the market at cheaper price? Is the demand for competing products increasing? Is the company's share in the total trade constant or has it been fluctuating?

Marking Scheme – 1 Mark for 1 Point (Four Points)

Q.2 (a) Difference between Due Diligence and Audit:

- Audit is an independent examination and evaluation of F.S. on an organization with a view to express an opinion thereon. (1 Mark)
- Due diligence refers to an examination of a potential investment to confirm all material facts of prospective business opportunity. It involves review of financial and non-financial records as deemed relevant and material. It aims to take the care that a reasonable person should take before entering into an agreement or a transaction with another party. (1 Mark)

(b) Steps involved in conducting due diligence:

- Due diligence to be started with an open mind. Do not assume that anything wrong will be found and look for it. What needs to be done is to identify trouble spots and ask for explanations.

- Get the best team of people. If required, due diligence experts may be hired from outside the firm. While hiring such professionals, their experience record needs to be taken care of.
- Get help in all areas like finance, tax accounting, legal, marketing, technology, and any others relevant to the assignment so that you get a 360-degree view of the acquisition candidate.
- Talk to customers, suppliers, business partners, and employees are great resources.
- Take a risk management approach. So, while you want to do your research, you also want to make sure that you do not antagonise the team of people of the target company by bogging them down with loads of questions.
- Prepare a comprehensive report detailing the compliances and substantive risks/issues.

Marking Scheme – 0.5 Mark for 1 Point (Six Points – 3 Marks)

Q.3 (a) Stages for reporting of internal audit results:

Reporting of internal audit results is generally undertaken in two stages:

- (i) At the end of a particular audit assignment, an “Internal Audit Report” covering a specific area, function or part of the entity is prepared highlighting key observations.

This report is generally issued with details of manner in which assignment was conducted and key findings from the audit procedures undertaken. This report is issued to auditee, with copies shared with local & executive management, as agreed during planning phase.

- (ii) On a periodic basis, at the close of a plan period, a comprehensive report of all the internal audit activities covering the entity and the plan period is prepared by the Chief Internal Auditor (or the EP, in case of external service provider).

Such reporting is normally done on a quarterly basis and submitted to highest governing authority (Audit Committee). Some part of the “Internal Audit Reports” may form part of the periodic (e.g. Quarterly) report shared with the Audit Committee.

Marking Scheme – 1 Mark for 1 Point (2 Marks)

(b) Type of report dealt by SIA 370:

SIA 370 deals with the internal auditor’s responsibility to issue only the first type of reports (the Internal Audit Report pertaining to specific audit assignments) and not to the periodic (e.g. Quarterly) reporting for the whole entity as per the Annual/Quarterly audit plan. (1 Mark)

(c) Key Elements to be included in Internal Audit Report:

Internal Auditor shall issue a clear, well documented “Internal Audit Report” which includes the following key elements:

- An overview of the objectives, scope and approach of the audit assignments;
- The fact that an internal audit has been conducted in accordance the Standards of Internal Audit;
- An executive summary of key observations covering all important aspects, and specific to the scope of the assignment;

- (d) A summary of the corrective actions required (or agreed by management) for each observation;
and
- (e) Nature of assurance, if any, which can be derived from the observations.

Marking Scheme – 0.5 Mark for 1 Point (Four Points – 2 Marks)

Q.4 Areas where a forensic professional is generally involved:

Forensic Accountant is generally involved in the below mentioned areas of work:

(a) Fraud Detection: Area of Fraud detection comprises of:

- Investigating and analysing financial evidence.
- Detecting financial frauds
- Tracing misappropriated funds.

(1 Mark)

(b) Fraud prevention: Area of fraud prevention comprises of:

- Reviewing internal controls to verify their adequacy
- Providing consultation in the development and implementation of an internal control framework aligned to an organization's risk profile

(1 Mark)

(c) Computer Forensics: Area of Computer forensics comprises of developing computerized applications to assist in the recovery, analysis and presentation of financial evidence.

(1 Mark)

(d) Expert Testimony: Area of Expert testimony comprises of

- Assisting in legal proceedings,
- Testifying in court as an expert witness
- Preparing visual aids to support trial evidence.

(1 Mark)

Pre-requisites a forensic professional must possess:

Forensic Professional must be familiar with legal concepts and procedures and have expertise in the use of IT tools and techniques that facilitate data recovery and analysis. In addition, a Forensic Professional must be able to identify substance over form when dealing with an issue.

(1 Mark)



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