

Roll No.

OPEN BOOK EXAMINATION

Time allowed : 3 hours

Maximum marks : 100

Total number of questions : 6

Total number of printed pages : 15

NOTE : Answer ALL Questions.

PART-I

1. (a) Headquartered in Mumbai, Armaments System Limited (ASL) was incorporated on 1st April, 2016, as a Public Limited Company, to be the manufacturing base for guided missile systems and allied equipment for defense sector forces. Company is equipped with the latest plant and machinery, apart from access to updated techniques supported by Standard Operating Procedure (SOP). The company's revenue increased from ₹ 250 crore to ₹ 600 crore in a period of three years through a combination of internal growth and acquisitions. The Company required additional internal auditing expertise and resources to meet new and changing compliance and internal control requirements. Accordingly, SAR & Co. Chartered Accountants is appointed to evaluate the effectiveness and adequacy of the following processes : procurement, risk management, and internal controls.

The main objectives to be achieved for procurement process were – (i) Ensuring compliance with international trade as more than 60% of required raw material is being imported. (ii) Identifying opportunities for cost savings and (iii) Identifying potential fraud, corruption and conflict of interest areas. While carrying out the risk assessment, internal audit team observed that management would not be alerted if there was either undue preference being given to a specific vendor or an unreasonable demand being

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placed on any one vendor. Further on many instances, purchases were made from dealers instead of manufacturers leading to extra cost for the company. Internal audit team thought that these types of circumstances are exceptional in nature. Audit team carried out the internal audit, keeping audit objectives in mind and randomly collected the following documents for verification and including them as samples in proposed audit report.

- Purchase Invoices issued by ABC Ltd.
- Purchase Orders give to TAB Ltd.
- Transfer documents from store to production department.
- Transfer documents from production room to finished goods store.

Audit team leader asked the audit team members to ensure that all the documents collected for internal audit purpose are clear and understandable.

Considering the above facts, answer the following :

(i) If you are a part of audit team, how will you ensure that audit documentation collected meet the criteria set out by Audit team leader ?

(3 marks)

(ii) Classify the documents collected into different categories according to their origin and availability.

(2 marks)

(iii) What kind of information should be included in the audit documentation for exceptional circumstances encountered during internal audit ?

(3 marks)

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- (b) RST Ltd. (a manufacturing company engaged in the business of various types of yarns) appointed KSB & Co. Chartered Accountants, as internal auditors of the company for the F.Y. 2024-2025. Statutory auditors wanted to have a meeting with Internal auditors to discuss some significant matters and areas where internal auditors should concentrate and the type of documentation that should be made by internal auditors so that it can be reviewed by statutory auditors in case serious lapses are pointed out by internal auditors. Management of RST Ltd. objected to this by saying that statutory auditors are not concerned anyway with the work performed by KSB & Co. How should statutory auditors deal with this situation ?

(7 marks)

2. (a) Perth Teach Ltd. (PTL,) started the business of manufacturing of cycles and cycle parts in Ludhiana in year 2016 and achieved good success since then. It manufactures and exports cycles of all categories of sports. PTL. provides job work services also for auto components manufacturing companies. The company keeps launching of new products to expand its reach. Internal audit team has worked brilliantly over the last two financial years and has ensured that non-compliances are very rare and controls are operating effectively. Documents of internal auditor includes the details of controls implemented at various levels as below :

Sr No.	Controls Implemented	Control Classification/Type
1	Segregation of duties, Background verification, Internal audits, Data Validation, monitoring quality controls	Preventive
2	Firewalls, Computer and server backups, reconciliations, audit trail, obtaining feedback	Detective
3	Prior approvals, financial reporting, physical verification, data verification	Input
4	Review of exception reports, Authorization procedure, financial statements, rotation of jobs	Output

You are required to explain why internal controls should exist in an organization and comment whether the above table represents the correct classification of controls.

(5 marks)

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- (b) A company has 25 branches in India. Draft an audit plan to monitor sales activities and receivables.

The total sales of the company in India is ₹ 200 crore and outside India ₹ 100 crore.

(a) What would be the possible control weaknesses in sales activities ?

(b) What should be the control feature in an activity of this kind ?

(5 marks)

- (c) The annual procurement of raw material by a company is 200 MT of steel and 100 MT of copper. The copper is used in winding for starter motors made by the company.

The management gets the winding done by a third party. The Board is of the opinion that the copper consumption is not as per the Bill of Material and is excessive. Draft an internal audit program to detect anomalies if any in the copper consumption.

(5 marks)

3. (a) Axum Bank Ltd. (ABL) is operating in major cities of India since the year 2009 with customer satisfaction score of 9 out of 10. Reason for such a good score is that bank is leader in implementing latest technologies for customer services and advancement of its operations. Information technology department of ABL has implemented the following two technology tools.

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- NPL EWS, an early Non-performing Loans (NPL) warning system. It is an enterprise software application that allows banks to predict NPLs with high accuracy. For this, the software combines AI, machine learning, and behavior analytics on banking and dynamic external data.
- Finance-key for simplifying treasury operations. Finance-key automates and centralizes treasury operations management. The software provides a dynamic dashboard for liquidity, payments, and compliance management. It delivers self-service reporting and real-time visibility into banking data, automating payment and treasury work flows.

One of the Big Four Accounting firms is rendering internal audit services to the bank and also uses advanced audit tools to achieve the desired audit objective. In its last meeting with audit team leader, audit team discussed the new technical advancements implemented by the client ABL and invited suggestions on what impact these technologies will have on internal audit function.

You are also a part of internal audit team and have been asked to discuss areas where audit team should focus in these circumstances.

(5 marks)

- (b) Established over three decades ago in 1985 by the visionary Ravinder Singh, TANN stands tall as a quality driven FMCG company. Its brand has evolved into a household name, synonymous with Bread & Bakery excellence, particularly dominating the markets of North India. Based in Jalandhar, its Head Office is the heartbeat of its operations, overseeing a network of 10 cutting-edge manufacturing plants strategically spread across North and Central India.

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TANN management has received a notice from State Pollution Control Department for submitting a compliance report on water and waste management systems implemented by the company. For compiling and submitting the required data, Raj who has worked as a head of preventive maintenance department (Machinery and pollution control equipment's) of the company for last three years has been entrusted the task. Considering his capability and experience in the said department, he has been asked to do audit environmental compliance of the company. Environmental audit will also help company to identify potential environmental risks (mainly water pollution) that may arise from their operations. For controlling water pollution, water treatment plant has been installed (supplied by firm owned by son of Raj). Raj was hesitant to carry out the entrusted task and requested management to assign the responsibility to some other person.

- (i) In your opinion why Raj was hesitant to accept the given role ?
- (ii) How should TANN make sure that such type of situations does not arise in the future ?

(1+4 marks)

- (c) Vertical Bank Ltd. (VBL) is an Indian private sector bank headquartered in New Delhi. It offers services across these verticals : corporate and institutional banking, commercial banking, branch and business banking, retail assets, development banking and financial inclusion, treasury and financial market operations. Share price of VBL has taken a hit in last quarter due to increase in provision of non-performing assets.

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VBL, as a part of good corporate governance, has implemented internal audit function on early identification, proper classification and provisioning of non-performing assets. RBI guidelines are getting updated/changed on regular basis and to ensure compliance of the same, a separate department has been set up with persons having requisite knowledge and expertise. For the FY 2023-2024, Singh & Associates, Chartered Accountants have been appointed as statutory auditors and auditors will be commencing audit from 15.04.2024. Management of the Bank has asked internal audit team to check the classification and provisioning of NPAs at its end so that statutory auditors do not give any adverse report in the form of memorandum of changes. The following information has been extracted for internal audit team :

Classification	NPA Amount (Rs in Lakhs)	Provision Made (Rs in Lakhs)
Standard (other than Comm. Real estate and SME)	10000.00	25.00
Standard (Comm. Real estate)	500.00	2.50
Sub-standard	3500.00	350.00
Doubtful (Secured and 18 months category)	1000.00	250.00
Doubtful (Unsecured and 18 months category)	500.00	250.00

Considering above, answer the following :

- (i) Whether the provision calculated is correct ? If not, calculate the correct provision to be made on NPAs.
- (ii) What features of banking operations make internal audit of banks challenging ?

(5 marks)
P.T.O.

Attempt all parts of either Q. No. 4 or Q. No. 4A

4. (a) The internal auditor carried out a confirmation of balance exercise with all suppliers. There were 568 suppliers, and the results were as follows :

Positive confirmation	200
Discrepancies noted by supplier	100
No response	268

One of the suppliers asked for a refund of ₹ 1,45,314 based on the confirmation letter. What actions should the internal auditor take ?

(4 marks)

- (b) In the course of internal audit, the following factors came to the light regarding GST of the ABC Trust :

- (1) The institution has exempt income of ₹ 2 crore. No invoices have been raised. No GST liability exists on this.
- (2) There is non-exempt income of ₹ 3 crore which is received. GST invoices have been raised and GST has been paid on them.
- (3) There is also non-exempt income of ₹ 4 crore which has not been received or billed. No GST has been paid on this amount even though GST(@ 18% is payable on the same. No invoices have been raised.

What action should the internal auditor report recommend in his report, and what corrective action should be recommended ?

(5 marks)

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- (c) Tele Mfg. Ltd. has a raw material consumption of ₹ 50 Crore per annum. It maintains a store consumption record. During the course of audit, the following facts came to light.

There has been an adverse material variance of ₹ 3 Crore and the reason for the same are :

- (i) Usage variance ₹ 1 Crore
(ii) Price variance ₹ 2 Crore

Draft an internal audit report to the Board, highlighting these facts. You may assume the reasons for the variance which should be highlighted in the report.

(6 marks)

OR (Alternate to Q. No. 4)

- 4A. (a) The Management of ABC Private Limited has appointed AAA and Co. (Chartered Accountant firm) as an internal auditor of the company who is also a statutory auditor of the ABC Private Limited.

Is the appointment of AAA and Co. as an internal auditor of the ABC Private Limited is valid ?

(2 marks)

- (b) Forex Ltd. has appointed CA Ravi as its internal auditor in the current financial year for a period of three years. Till last year internal auditor used to give detailed observations to the concerned departments for comments before preparation of the final internal audit.

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Management has requested the new internal auditor that besides carrying out internal audit, how can internally audit function be a helpful tool to the management.

CA Ravi has not worked on this type of scope of work and was in dilemma to handle the concerns of the management.

Can you guide CA Ravi in understanding the concern by listing down some areas where internal audit function (as an effective tool) can help management ?

(5 marks)

- (c) ABSOLUTE HEALTH, a hospital network offering end-to-end healthcare services, has pioneered the quality revolution in the field of healthcare delivery in the country, making quality healthcare affordable and accessible to everyone. Today, ABSOLUTE HEALTH stands among the top 10 hospitals in India with top-notch healthcare delivery systems, evidence-based medicine, high-end facilities and quality-oriented practices. Beyond healthcare delivery, ABSOLUTE HEALTH also has a clear-cut focus on academics with 23 different academic programs under its academic wing. ABSOLUTE HEALTH touches upon all aspects of wellness and healthcare, with a fine fusion of cardinal principles of holistic care and hospitality with the three-pronged approach of courtesy, compassion, and competence. As a part of good corporate governance, management has implemented strong internal controls over cash disbursements (pertaining to lower-level staff salaries, purchases up to ₹ 10000, propriety aspect while doing purchases, proper recording and classification of payments etc.) Analysis of SAP generated report for the last month indicates the following :

- Instances of payment of personal credit card bills of two employees working in accounts department.

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— Charging personal expenses on company card bills.

Matter was taken up by the internal audit department of the company and one of the team members have been asked to prepare checklist for identifying the control system working and its weakness in disbursement area before starting the actual audit.

You are required to assist the audit team member in preparing cash disbursement checklist or questionnaire for the said area.

(8 marks)

PART-II

5. Royals India Ltd. (RIL) is an Indian sports equipment manufacturer based in Delhi. RIL makes equipment for multiple sports, among them basketball, football, volleyball, handball, cricket, tennis, rackets, table tennis and roller skating as well as fitness equipment. Company has four subsidiaries outside India and regular sale/purchase transactions takes place between RIL and its subsidiaries. One of its subsidiaries, based in Unites States of America, handles retail sales also in USA. The main raw material used for manufacturing equipment is wood which is supplied by Fair Supply Ltd. (FSL) based in Tamil Nadu. Besides this, other raw material like rubber, latex, cotton, wires for badminton racket etc. are procured from various other vendors as per requirement and using Non-PO route basis.

Analysis of last three years' procurement data shows that major quantity of badminton wires has been supplied by only one company TAR Ltd. (a distributor of different types of badminton wires). Total business obtained by TAR Ltd. from RIL in last three years has increased from 25 crore to ₹ 100 crore. Board of Directors came to know of this and are suspicious as to why same company is getting repeated orders. Their suspicion got confirmed when one whistleblower raised issue that payments to TAR Ltd. is being made on priority basis

and that too with little credit period as against normal credit period of 30 days availed from other suppliers. Possibility of collusive bidding also cannot be ignored in this case. As per consensus, forensic auditor was appointed to investigate in detail the purchases made from TAR Ltd. to identify any fraudulent purchases and review the procurement process in detail to identify the risk associated with procurement process.

For the same period of three years, supplies of various sports equipments's manufactured to US subsidiary amounts to ₹ 750 crore. Analysis of consolidated financial statements for said three years show that the operating margin earned by US subsidiary on same products is more than the margin earned by RIL. Internal Auditors also included the same fact in their audit report and advised the company to check its pricing policy for the future. Management is of the view that no change in pricing is required. In the meantime, Income Tax department after analyzing the exports of same type of goods by other companies has initiated scrutiny for its financial dealings with its subsidiary.

Considering the facts above, answer the following :

- (i) What will be the objectives of the forensic auditor appointed in this case ?
(5 marks)
- (ii) How will forensic auditor find out existence of collusive bidding, if any ?
(3 marks)
- (iii) What areas will be the areas of risk which a forensic auditor can consider reporting to the management ?
(5 marks)
- (iv) Independent forensic auditor appointed by Income Tax Department to identify siphoning of funds to its offshore entity to evade taxes. What areas will forensic auditor look for to identify siphoning of funds through transactions with US subsidiary ?
(7 marks)

: 13 :

Attempt all parts of either Q. No. 6 or Q. No. 6A

6. In 2008, driven by a passion for the world of data, Vishal and Vikas founded Excellent Data Ltd. (EDL). Today, after over 15 years, EDL is more than an organization; it's a tight-knit community of enthusiasts united by one thing—the passion to tackle real-world challenges with data. Growth story of Data science, data analytics in future is going to be big and keeping this aspect in mind, EDL management is considering acquiring other companies in the same field to increase its reach, competitiveness, diversification and customer base. Investment in and acquisition of companies engaged in providing AI services is also on the cards. The following companies were shortlisted for considering the acquisition :

- (i) Latest Technologies Ltd. (engaged in Master Data Management, Data lineage/Metadata, Data Archival, Data masking, Data quality and Data Security).
- (ii) CBF Technologies (engaged in providing AI solutions).

EDL knows that these types of decisions have long term impacts on the company, so decided to have forensic audit conducted of the proposed companies to be acquired from a qualified professional. Accordingly, EDL has approached you to help them by conducting thorough investigation and highlighting the important aspects to be considered. (Approval for investigation has been taken from the stakeholders of both the proposed companies). Considering your experience and reputation of business investigations, management has instructed you to keep the following things in mind while submitting the report :

- Considering the presence of proposed acquiree's in African countries, money laundering activities possibility cannot be ruled out. Assurance required that no such possibility exists by examining the relationship between company and shell companies, if any.
- Go beyond the conventional financial measures to consider qualitative factors relevant for evaluating the performance and prospects of the company.

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- Include in the report, statement to show the trend as well as changes that have taken place in the financial position of the company.
- Mention separately cash generated from business only.

Considering the above information, answer the following :

- (i) What should be the methodology to find out money laundering activities using shell companies ?
(6 marks)
- (ii) What factors other than conventional financial measures will be reported ?
(6 marks)
- (iii) What type of ratios will be used to show the trend as well as changes that have taken place in the financial position of the company ?
(4 marks)
- (iv) From which document will you be able to retrieve the cash generated from business operations and how will you analyze the same ?
(4 marks)

OR (Alternate to Q. No. 6)

- 6A. (a) RTQ Ltd. has decided to introduce a system of employee verification. The background to this is that in a sister concern, a group of employees had jointly committed a fraud in assets consisting of stock and cash to the tune of ₹ 50 lakh through collusion. You are an expert forensic auditor and have been asked to elaborate the steps for employee verification. Detail the steps to be taken for the same.
(5 marks)
- (b) A company XYZ Ltd. intends to appoint A, who was earlier convicted of fraud as internal auditor. Comment.
(3 marks)

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(c) ABC Club has the following categories of members :

	PARTICULARS	COUNT	Maximum Limit
(a)	Honorary	200	NA
(b)	Permanent	1400	1600
(c)	Members' children	2400	NA
(d)	Corporate	100	125
(e)	Temporary	500	600

The Permanent Membership is in great demand and there is a waiting list of 20 years for members after application. The limit of 1600 members includes honorary members. For members' children, there is no waiting list and on attaining the age of 21, membership is automatic.

The management is of the view that there is a fraud in this area. You have been asked to verify the records of members' children.

- (i) What steps will you take as a forensic auditor to verify ?
- (ii) What methodology will you adopt ?
- (iii) What will be the limitations of your report ?
- (iv) What action will you recommend against the employees involved in fraudulent activities ?

(3 marks each)

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