

1. Pvt Ltd is a dealer of cars. The business is quite old which is into dealing of premium cars. As per the industry practices, it is required to offer two free car services to the customers on purchase of a new car. Any service after first 2 services is chargeable. The cars sold by the company have a warranty period of 3 years. The company also has authorized service centres where car service is provided to the customer.  
Currently there is no mechanism to track whether the free services offered to the customers are limited to two or not. Internal auditor of the company has raised this point in his report. Please suggest your views on the observation of internal auditor.
  - a) The management currently does not have any control on the services offered. The management already has a plan to put a process in place to track and control this and hence the internal auditor may consider not reporting the same.
  - b) The management believes that such type of instances would be very few and overall impact of the same would not be significant. Considering this the observation of the internal auditor is of no significance.
  - c) The management currently does not have any mechanism for tracking free and chargeable services. The company may be spending significant amount of money on this which should be tracked and accordingly this matter should be reported by the internal auditor.
  - d) The management agrees with the observation of the internal auditor but has also explained that such instances arise in exceptional cases for which approvals were obtained. Hence the management believes that this observation should be ignored by the internal auditor.
2. DDD Ltd is in the business of bauxite mining. The company has got various lease operations. The annual turnover of the company is INR 5789 crores and profits are increasing significantly. Please advise in respect of bauxite mining and lease operations, the internal auditor would need to verify which of the following:
  - i. The period of validity of the various mining leases obtained by the company.
  - ii. Steps taken to renew the existing leases. Where the expiry dates are near and in case deposits/ reserves of the existing mines are near exhaustion, whether application has been made for new leases.
  - iii. Where backfilling of waste rocks in the area excavated during mining operations is not feasible, whether a separate site has been created for dumping the waste and whether such waste dumps have been suitably created, terraced and stabilised through vegetation or otherwise.
  - iv. The records in respect of each earth moving equipment, showing the hours worked, idle hours, consumption of fuel and lubricant and output of the machine during such working hours.
  - v. The written contracts and compliance with the terms and conditions thereof where the mining activities of leasehold mines have been outsourced.
  - a) i, ii, iii, iv and v.
  - b) i, ii, iii and iv.

- c) i, iii, iv and v.
- d) i, ii, iii and v.
3. ESC Ltd is a listed company and has annual turnover of INR 4000 crores. The company needs to strengthen GST (Goods and Services Tax) application as per Goods and Services Tax Act, applicable from 1 July 2017, Integrated Goods and Services Tax (IGST) is levied in case of inter-state supply of goods and services. In case of intra-state supply of goods and services, CGST and SGST is levied. During review of the tax liabilities on goods received in the period 1 July 2017 to 31 Oct 2017 by the internal auditors, following gaps were observed:
- A) On review of the tax liabilities on 1,231 transactions (total value INR 5 Crores) processed in the period 1 July 2017 to 31 Oct 2017, it was noted that incorrect GST rates were applied on goods, resulting in an excess deposit of tax amounting to INR 46 Lacs.
- B) In 8 instances it was noted that tax was computed at multiple rates for the same material code.

The internal auditors highlighted that above observations had potential risk/ impact of financial loss and possible statutory non-compliance with tax laws.

Please suggest which one of the following is correct.

- a) Internal auditor should report this matter.
- b) Internal auditor should discuss with management about way forward and drop this point.
- c) Internal audit observation is not right.
- d) Internal auditor should ignore on the grounds of materiality.
4. ACI Ltd is in the business of textiles and its imports are significant. The company is in the growing phase and plans to expand its operations significantly. For doing this the company is also evaluating to procure the items locally which are currently imported. This would lead to decreased procurement costs and may help in increasing profitability. In respect of the current operations of the company, the management would like to have your views in respect of imports where the internal auditor should focus. Please suggest.
- i. Check whether import orders are properly authorised and in-house authority limits are being followed.
- ii. Check whether requisitions are received in time within the validity period of the import license.
- iii. Check ordering date in relation to the import license validity and examine license utilisation.
- iv. Analyse refund claims of penalty and duty and check whether any claim has been rejected.
- v. Check whether there is a proper system for checking of demurrage, wharfage, clearing expenses on imports.
- vi. Check whether purchases made through agents are properly approved with reasons/ benefit for such purchases.
- a) i, ii and iii.
- b) i, iii and iv.

- c) i, ii, iv, v and vi.
- d) i, ii, iii, iv, v and vi.
5. As per the process of the company, Non Disclosure Agreements (NDA) need to be obtained before a request for quotation is sent to the vendor. The standard NDA is valid for 3 years and any information vendor receives after the expiry of the NDA is not covered under the agreement.
- During the internal audit of controls around vendor selection and vendor code creation, it was observed by the internal auditors that currently there is no mechanism to track and monitor the expiry dates of such NDAs.
- On a review of 20 sample vendors for direct materials, it was noted that:
- In 2 instances, the NDAs were not obtained from the vendor.
  - In 2 instances the NDAs were expired at the time of review.
  - In 2 instances the NDAs were dated post the vendor creation date.
- Further it was also observed that the background check for director/ key management personnel was not performed for vendors before empanelment.
- Please suggest the internal auditors in respect of this matter.
- a) Internal auditor should recommend that the monitoring mechanism needs to be introduced for ensuring timely renewal of NDAs and background checks should be conducted for all new vendors added in the empanelment list.
- b) Internal auditor should recommend that the monitoring mechanism needs to be introduced for ensuring timely renewal of NDAs. Performing background checks is not so important and internal auditor should ignore this.
- c) Internal auditor should recommend background checks to be conducted for all new vendors added in the empanelment list and should drop the matter related to NDA as that is not important.
- d) Internal auditor should look at the significance of both matters and looking at that can ignore both these points.
6. AARK Ltd is a manufacturing company having turnover of Rs 230 crores. The company has 3 plants and all of them are operating at full capacity. The inventory levels of the company have increased quite a lot in last 3 years. In respect of issues of materials to manufacturing process/ production shop, please suggest the procedures of the internal auditor.
- i. Checking that the requisitions from the production shops are duly authorised.
  - ii. Ensuring that deliveries from material handling shop/ stores are the exact quantities as per the requisitions.
  - iii. Checking whether shop is over-indenting leading to store build-up at shop-floor level.
  - iv. Checking whether spares requisitioned by engineering department are duly supported by authorised signatures and capital items are not being requisitioned for maintenance.
- a) i, ii and iii.
- b) i, iii and iv.
- c) ii, iii and iv.

d) i, ii, iii and iv.

7. AKR Ltd is in the business of trading and manufacturing of readymade garments. The company's annual turnover is Rs. 1100 crores. The company's management wants to strengthen its processes in next 2 years. Before a blanket PO is raised to a vendor for direct material, a signed agreement is obtained that binds the vendor with crucial terms such as timely delivery, quality standards, penalties etc. The standard vendor agreement is valid for 3 years. On a review of 20 sample vendors for direct material, it was observed by the internal auditor that in some instances - a signed vendor agreement had not been obtained, the vendor agreement had expired and the vendor agreement was dated post vendor creation. The root cause was there was no monitoring mechanism to track the validity of vendor agreements. Management explained that it will ensure that vendor agreements are obtained from vendors before RFQs(Request for Quotation) are sent to them. Management will put in place a monitoring mechanism to ensure timely renewal of vendor agreements for existing vendors. In this case, please suggest the internal auditor.
- Internal auditor has discussed the way forward with management and should drop this point.
  - Internal auditor should report this matter.
  - Internal audit observation is not right.
  - Internal auditor should ignore on the grounds of materiality.
8. NMP Ltd is in the business of retail and has been suffering losses. The turnover of the company has been same over the last 3-5 years. The company has Oracle as its ERP package. The internal auditor of the company observed that there is no process to review the supplier master on a periodic basis to identify the cases of incorrect updation / redundant supplier codes, key fields were not made mandatory in Oracle at the time of vendor empanelment and maker checker mechanism was also not enabled in Oracle. There is no mechanism to track redundant supplier codes and block them for further transactions. For 5,750 out of 9,076 active suppliers (63.3%), no transaction had occurred in the past 180 days. For 4,972 out of these 5750, no transaction occurred in the past 1 year. For 35 out of 9,076 active suppliers, the state code in the GST Identification Number (GSTIN) updated in the supplier master did not match the state mentioned in supplier's address. Payments valuing INR 27 crores have been made to such suppliers. Management explained that for redundant supplier codes, annual review will be conducted by the purchase team to identify such codes and, post an approval from finance, purchasing will be blocked for the respective vendors. For GSTIN and State mismatch, management has already commenced assessment to identify the reasons for such errors and all such inconsistencies will be rectified in next 6 months. Please suggest in terms of reporting.
- Management responses look reasonable and this matter should be dropped.
  - The matter is more of related to hygiene and may not have any impact on the financial reporting and hence should be ignored.
  - Internal auditor need to report this matter.

- d) Internal auditor should look at the significance of the matter. Material and on the basis of the same should decide about reporting this matter.
9. During the expense review of a company, the auditor noted that interest on loan is wrongly calculated by the finance company for the previous years. It was already verified as correct by the statutory auditors and forms part of their balance confirmation process. Furthermore, the accountant has already identified the error and has planned to correct it in the next month by taking it up with the finance company. What should be the best course of action for the auditor?
- a) Ignore the error as it is already verified by the statutory auditors with confirming balances.  
 b) Report the error as it affects financial reporting.  
 c) Ignore the error as it is already being taken up with the finance company by the accounts team.  
 d) Ignore the error as accuracy of interest calculation is not part of the scope of internal audit.
10. Aalhad & Co sells cars, car parts and petrol from 25 different locations in one country. Each branch has up to 20 staff working there, although most of the accounting systems are designed and implemented from the company's head office. Aalhad has an internal audit department of six staff, all of whom have been employed at Aalhad for a minimum of five years and some for as long as 15 years.
- Which of the following will limit the independence of the chief internal auditor of the company?
- a) The chief internal auditor reports to the Finance director of the company.  
 b) The scope of work of the internal audit department decided by the chief internal auditor, with the assistance of an audit committee.  
 c) All the accounting systems are designed and established by the management, the internal audit department audits the controls in the system.  
 d) The existing staff should be rotated into different areas of internal audit work and the chief internal auditor independently review the work carried out.

**Answer Keys**

1.	(c)	2.	(a)	3.	(a)	4.	(d)	5.	(a)
6.	(d)	7.	(b)	8.	(c)	9.	(b)	10.	(a)