



Chartered Institute of Internal Auditors

IIA Diploma in Internal Audit Practice

P2 Financial Risks and Controls

Sample multiple choice questions

This document provides examples of the types of multiple choice questions that appear in Part A of the examination paper. However, the sample is not exhaustive insofar that they do not cover the whole syllabus. In addition, there are 15 sample questions; in the examination paper there are 20 questions.

Question 1 Company X buys goods on credit from one of its suppliers, company Y, How should this transaction be recorded in the books of company X?

	Account debited	Account credited
A	Company Y	Purchases
B	Company Y	Inventory
C	Purchases	Company Y
D	Inventory	Company Y

Question 2 Within the statement of financial position, according to the International Accounting Standards, retained earnings are classified as:

- A** Non-current assets
 - B** Current assets
 - C** Equity
 - D** Current liabilities
-

Question 3 Consider the following balances from a company's financial statements:

	£000
Borrowings	30
Cash	10
Equipment	30
Inventory	10
Retained earnings	50
Trade receivables	12

What is the figure for current assets?

- A** £82,000
 - B** £32,000
 - C** £30,000
 - D** £20,000
-

Question 4 The following is an extract of balances from a company's accounts:

	£
Borrowings	3,200
Cash	1,300
Inventory	2,500
Property, plant and equipment	9,200
Retained earnings	1,600
Revenue reserves	4,300
Tax liabilities	?
Trade payables	3,800
Trade receivables	3,000

What figure for tax liabilities would balance the statement of financial position?

- A £14,900
 - B £11,700
 - C £3,100
 - D £500
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Question 5 Internal and external audit are similar in that:

- A both services can be provided by in-house and external providers
 - B both provide independent assurance
 - C both report to shareholders
 - D neither are statutorily required in the UK
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Question 6 What aspect of financial reporting does accounting standard IAS 7 relate to?

- A Statement of cash flows
 - B Statement of changes in equity
 - C Statement of comprehensive income
 - D Statement of financial position
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Question 7 At 31 December, a company's trade receivables totalled £60,000 and the allowance for doubtful receivables was £2,000. The company decided to adjust its allowance for doubtful receivables to five per cent based on previous experience.

What figure should be included in the statement of comprehensive income for doubtful receivables for 31 December?

- A £5,000
 - B £3,000
 - C £2,900
 - D £1,000
-

Question 8 A company has just purchased furniture for £12,000. The furniture has an estimated useful life of four years; and the estimated residual value is £1,000. The company uses the straight-line method of depreciation.

What would be the accumulated depreciation figure in the company's accounts at the end of the second year?

- A £2,750
 - B £3,000
 - C £4,000
 - D £5,500
-

Question 9 A small publishing company has the following information about its inventory of a particular publication:

Number of items in stock	150
Selling price per item	£35
Selling costs per item	£11
Materials and print costs per item	£12

At what figure should the inventory be valued in the year end financial statements?

- A £1,650
 - B £1,800
 - C £3,450
 - D £3,600
-

Question 10 A manufacturer of designer shoes has the following management accounting information:

Sales price	£120 per pair
Materials	£4 million per annum
Labour	£3 million per annum
Factory overheads	£1.5 million per annum
Total sales	100,000 pairs per annum

What is the contribution of each pair of shoes?

- A £35
 - B £50
 - C £70
 - D £85
-

Question 11 A company is planning to build new housing but is facing a shortfall in its projected income and will need to borrow. It wishes to keep its interest costs to a minimum by taking the borrowing at the latest possible time.

The company's bank balance was £70,000 on 1 July. Its monthly income is £90,000 per month and outgoings £60,000 per month. Additional outgoings of £80,000 per month will be incurred from August to pay for building work.

When will the company need to borrow?

- A August
 - B September
 - C October
 - D November
-

Question 12 The following information relates to one day's sales of ten products from a clothing range of a market trader:

Product 1	6	Product 6	12
Product 2	10	Product 7	5
Product 3	6	Product 8	12
Product 4	5	Product 9	15
Product 5	20	Product 10	12

What are the median and mode averages for the sales of the ten products?

	Median	Mode
A	10	3
B	10.3	12
C	11	12
D	12	12

Question 13 Sales in Y2 were £30,000 more than they were in Y1. This represented a 20% increase on Y1. What was the level of sales for Y2?

- A £90,000
 - B £120,000
 - C £150,000
 - D £180,000
-

Question 14 The following is an extract from a company's statement of financial position:

£

<i>Assets</i>	
Non-current assets	15,000
Inventory	3,000
Trade receivables	2,500
Cash	500
Total assets	21,000
<i>Equity and liabilities</i>	
Retained earnings	8,500
Share capital	10,000
Share premium	1,000
Trade payables	1,200
Other payables	200
Taxation	100
Total equity and liabilities	21,000

What are the current and acid test ratios?

	Current	Acid
A	4:1	2:1
B	2:1	4:1
C	0.48:1	0.24:1
D	0.24:1	0.48:1

Question 15 The following is an extract from the financial statements of a company:

	£000
Cash	10
Current liabilities	350
Equity and non-current liabilities	500
Profit before interest and tax	240
Revenue	800
Trade receivables	100

What is the return on capital employed for the company?

A	160%
B	94%
C	48%
D	28%

SOLUTIONS TO QUESTIONS

Question 1

Answer C

Feedback Purchases is the account that is used to record the goods for resale bought during the accounting period. It is like an expense account and is therefore debited, the business having gained the goods. The credit is posted to company Y because they are owed money ie they are the creditor.

See section 2.4 of the learning text (2nd edn)

Syllabus 2.4

Question 2

Answer C

Feedback Equity is capital owed by the company to its owners (such as shareholders), and thus profit (retained earnings) is classified as equity. Current assets are cash and cash equivalents; assets held for collection, sale, or consumption within the company's normal operating cycle; or assets held for trading within the next 12 months. All other assets are non-current. Current liabilities are those to be settled within the organisation's normal operating cycle or due within 12 months, or those held for trading, or those for which the entity does not have an unconditional right to defer payment beyond 12 months. Other liabilities are non-current.

See section 8.3.1 of the learning text (2nd edn)

Syllabus 4.4 and 5.1

Question 3

Answer B

Feedback The current assets from the items provided are cash, inventory and trade receivables. The sum of these three items is £32,000. Borrowings is a liability, equipment is a non-current asset, and retained earnings is equity.

The other options are wrong for the following reasons:

A: The figure is based on the incorrect addition of retained earnings.

C: The figure is based on incorrect treatment of equipment as a current asset.

D: The figure is based on the failure of including trade receivables as a current asset.

See section 8.6.1 of the learning text (2nd edn)

Syllabus 4.4

Question 4

Answer C

Feedback The elements that make up assets, the 'top half' of the statement of financial position, are cash, inventory, property, plant and equipment, and trade receivables. The total sum for assets is £16,000. The elements that make up equity and liabilities, the 'bottom half' of the statement, are borrowings, retained earnings, revenue reserves, trade payables and tax liabilities. The total for equity and liabilities from the available figures is £12,900 (that is, borrowings *plus* retained earnings *plus* revenue reserves *plus* trade payables). For the statement to balance, tax liabilities must be £3,100 (that is £16,000 *minus* £12,900).

The other options are wrong for the following reasons:

- A:** The figure is based on the incorrect treatment of revenue reserves and retained earnings as assets.
- B:** The figure is based on the incorrect treatment of revenue reserves as an asset.
- D:** The figure is based on the incorrect treatment of cash as equity in the statement of financial position.

See section 8.6.1 of the learning text (2nd edn)

Syllabus 4.4

Question 5

Answer B

Feedback Internal and external audit are similar in that they both provide independent assurance. However, whilst internal audit can be in-house, external audit has to be an external service. Internal audit provides assurance to the board, and thus may be regarded as reporting to the board. External audit reports to shareholders (or members, in the case of a membership organisation). Whilst external audit is statutory requirement in the UK, internal audit is not.

See section 10.3.5 of the learning text (2nd edn)

Syllabus 4.9

Question 6

Answer A

Feedback IAS 7 sets out the requirements of statements of cash flows. The requirements for the other statements are set out in IAS 1. However, the requirements for particular items within each statement may be addressed by other standards.

See section 12.3.2 of the learning text (2nd edn)

Syllabus 5.1

Question 7

Answer D

Feedback The allowance for doubtful receivables (or doubtful debts) for 31 December can be calculated as:
(5% of £60,000) *minus* £2,000. This equals £1,000.

The other options are wrong for the following reasons:

A: The £2,000 provision has been incorrectly added rather than subtracted.

B: This figure does not take account of the £2,000 provision.

C: This figure is based on deducting five per cent from £2,000.

See section 11.3 of the learning text (2nd edn)

Syllabus 5.5

Question 8

Answer D

Feedback The formula for the straight-line method is:
(Purchase value of asset *minus* estimated residual value)/Estimated useful life.

Thus, the figure for depreciation can be calculated as:

(£12,000 *minus* £1,000)/4, which comes to £2,750.

The depreciation figure in each year is £2,750. However, the accumulated depreciation is £5,500.

See section 11.5.4 of the learning text (2nd edn)

Syllabus 5.6

Question 9

Answer B

Feedback Inventory should be valued at lower of cost and net realisable value.
Cost: £12 x 150 = £1,800
Net realisable value: (£35 *minus* £11) x 150 = £3,600.
Cost is lower, and thus should be the figure recorded in the financial statements.

See section 11.6 of the learning text (2nd edn)

Syllabus 5.7

Question 10

Answer B

Feedback The formula for contribution is sales value *minus* variable costs. The variable costs that are provided are materials and labour, which total £7 million. To calculate the variable cost for each item, you divide this figure by the number of shoes sold in the year, thus £7 million/100,000, which works out as £70. Deducting this figure from the sales price will give you the contribution: £120 *minus* £70 = £50.

See section 17.2 of the learning text

Syllabus 6.3 and 6.6

Question 11

Answer C

Feedback A cash budget illustrates the forecast position:

	July	Aug	Sept	Oct
	£	£	£	£
Inflows	90,000	90,000	90,000	90,000
Outflows	60,000	60,000	60,000	60,000
Building work		80,000	80,000	80,000
Net inflows/(outflows)	30,000	(50,000)	(50,000)	(50,000)
Opening balance	70,000	100,000	50,000	NIL
Closing balance	100,000	50,000	NIL	(50,000)

The other months are incorrect for the following reasons:

- A:** A considerable surplus is held by the company in August.
- B:** The company is able to finance the building work from retained cash.
- D:** The company would have a significant overdraft by this time if it had not borrowed in October.

See section 18.7 of the learning text (2nd edn)

Syllabus 6.10

Question 12

Answer C

Feedback The median is the middle value of a set of numbers arranged in ascending order. If there is an even number of values, as is the case in this question, the median is the average value of the two middle numbers. The mode is the most frequent value from a given set of numbers.

The values in ascending order are: 5, 5, 6, 6, 10, 12, 12, 12, 15 and 20. Thus, the median can be calculated as $(10+12)/2$, which comes to 11. And the value that occurs most frequently is 12. Thus, this is the mode.

See section 14.5.2 of the learning text

Syllabus 7.3

Question 13

Answer D

Feedback The Y1 sales figure can be calculated as $\text{£}30,000/20\%$, which comes to $\text{£}150,000$. Year 2 sales are $\text{£}150,000$ plus $\text{£}30,000$, which is $\text{£}180,000$.

See section 14.5.1 of the learning text (2nd edn)

Syllabus 7.3

Question 14

Answer A

Feedback The current ratio is current assets : current liabilities. The items that make up current assets are inventory, trade receivables and cash; and the items that make up current liabilities are trade payables, other payables and taxation. Thus:

current assets:current liabilities is $\text{£}6,000:\text{£}1,500$, giving a ratio of 4:1.

The acid test ratio excludes inventory, and thus, the figures are $\text{£}3,000:\text{£}1,500$ giving a ratio of 2:1.

The other options are wrong for the following reasons:

B: Current ratio and acid test ratio have been confused.

C: Share capital and premiums have been incorrectly classified as current liabilities.

D: Share capital and premiums have been incorrectly classified as current liabilities; and current ratio and acid test ratio have been confused.

See section 13.4.1 of the learning text (2nd edn)

Syllabus 7.5

Question 15

Answer C

Feedback The formula for calculating the return on capital employed is:
(Profit before interest, tax and dividends)/(Equity and long-term loans etc) x 100.
Thus, the calculation is: 240,000/500,000 x 100, which equals 48%

The other options are wrong for the following reasons:

A: The figure is based on dividing revenue (rather than profit before interest and tax) by equity and non-current liabilities.

B: The figure is based on dividing revenue by equity and total liabilities.

D: The figure is based on dividing profit before interest and tax by equity and total liabilities.

See section 13.3.1 of the learning text (2nd edn)

Syllabus 7.5
