# Paper – 19: Cost and Management Audit

## Paper – 19 - Cost and Management Audit

**Full Marks : 100** **Time allowed: 3 hours**

**Answer Question No. 1 which is compulsory and carries 20 marks and any five from Question No. 2 to 8.**

**I. Answer the following:**

**1. (a) Fill in the blanks: [5×1=5]**

**(i) Abnormal loss of material is charged to __________.**
**(ii) Form A of XBRL is used for ___________ Report of a company.**
**(iii) Systematic examination, analysis and appraisal of management's overall performance is done in _________ audit.**
**(iv) Any casual vacancy in the office of a cost auditor, shall be filled by the Board of Directors within _______________ days of occurrence of such vacancy.**
**(v) The Companies are required to maintain Cost Records if turnover exceeds ___________ crores or more during immediately preceding Financial Year in respect of the products and services specified.**

**(b) State whether the following statements are true or false: [5×1=5]**

**(i) In case of utilities generated for the purpose of inter unit transfers, the distribution cost incurred for such transfers need not be added to the cost of utilities.**
**(ii) XBRL is a language based on XML family of languages.**
**(iii) Interest and finance charges are considered to be part of cost of production.**
**(iv) Cost Audit is to be conducted only when the shareholders of the Company direct such an audit at the Annual General Meeting.**
**(v) Maximum amount of penalty payable by the Cost Auditor for non-compliance with the provisions of Companies [Cost Audit Report] Rules 2014 is ₹ 5,000.**

**(c) Answer any five of the following in one or two sentences: [5×1=5]**

**(i) How would you compute the cost of utilities as per CAS – 8 when the utilities are generated for the purpose of Inter Unit Transfer?**
**(ii) Define Energy Audit**
**(iii) Define Corporate Branding.**
**(iv) Explain Sun Set Clause in one or two sentences.**
**(v) What means 4-digit CETA Code as explained in the Companies [Cost Records and Audit] Rules, 2014?**
**(vi) Whether the Companies (Cost Records and Audit) Rules, 2014 is applicable to a company which is classified as a micro enterprise or a small enterprise including as per the turnover criteria under section 7(9) of the Micro, Small and Medium Enterprises Development Act, 2006?**

**Answers.**

**1(a).**

(i) Profit and Loss
(ii) Filing Compliance
(iii) Management

(iv) 30
(v) ₹35 crores

**1(b).**

(i) False
(ii) True
(iii) False
(iv) False
(v) True

**1(c).**

**(i)** Cost of Utilities generated for the purpose of Inter unit transfers shall comprise of direct material cost, direct employee cost, direct expenses, factory overheads and the distribution cost incurred for such transfers.

**(ii)** Energy Auditing is an activity that serves the purposes of assessing energy use, pattern of a factory or energy consuming equipment and identifying energy saving opportunities in reducing avoidable losses, improving the effectiveness of energy use and increasing energy use efficiently. The energy Auditor is normally expected to give recommendations on effective improvements leading to monetary benefits and also advise on energy management issue, Generally energy auditor for the industry is an external party.

**(iii)** Corporate Branding is the process of creating and maintaining a favourable reputation of the company and its constituent elements.

**(iv)** Sun Set Clause is a measure within a statute regulation or other law that provides that the law shall cease to have effect after a specific date, unless further legislative action is taken to extend the law.

**(v)** Rule 2 (aa) of the Companies (Cost Records and Audit) Rules 2014 states that "Central Excise Tariff Act Heading" means the heading as referred to in the Additional Notes in the First Schedule to the Central Excise Tariff Act, 1985 [5 of 1986] in respect of goods a description in list of tariff provisions accompanied by a four digit number and includes all sub-headings of tariff items the first four-digits of which correspond to that number.

**(vi)** The Companies (Cost Records and Audit) Rules, 2014 is not applicable to a company which is classified as a micro enterprise or a small enterprise including as per the turnover criteria under section 7(9) of the Micro, Small and Medium Enterprises Development Act, 2006.

**II. Answer any FIVE from Question No. 2 to 8. Each question carries 16 marks.**

**2. (a) What are the duties and liabilities of a Cost Auditor relating to reporting of frauds identified during audit? [6]**
**(b) "The Cost Audit report contains significant information which would help to access and improve operational efficiency of a concern". Discuss the statement with reference to the matters to be reported by a Cost Auditor in his report? [10]**

**Answers:**

**2(a)** Reporting of fraud by Cost Auditor-

1) For the purpose of sub-section (12) of section 143, in case the auditor has sufficient reason to believe that an offence involving fraud, is being or has been committed against the company by officers or employees of the company, he shall report the matter to the Central Government immediately but not later than sixty days of his knowledge and after following the procedure indicated herein below:
   i. Auditor shall forward his report to the Board or the Audit Committee, as the case may be, immediately after he comes to knowledge of the fraud, seeking their reply or observations within forty-five days;
   ii. On receipt of such reply or observations the auditor shall forward his report and the reply or observations of the board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days of receipt of such reply or observations;
   iii. In case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty-five days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he failed to receive any reply or observations within the stipulated time.
2) The report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered post with Acknowledgement Due or by speed post followed by an e-mail in confirmation of the same.
3) The report shall be on the letter-head of the auditor containing postal address, e-mail address and contact number and be signed by the auditor with his seal and shall indicate his Membership Number.
4) The report shall be in the form of a statement as specified in Form Adt-4.

**2(b)** (I) The Cost Auditor has to report whether the Cost Accounting System followed is adequate for determination of the fair cost of production.

(II) He has to report on the financial performance of the company as well as of the product under cost audit, along with various ratios and offer comments on the ratios.

(III) He has to indicate the percentage of production in relation to the installed capacity expressed in appropriate units of measurement. He has also to state reasons for the shortfall in production bringing out clearly the extent to which they are controllable both in short term as well as long term.

(IV) He has to give observations as regards variations, if any, in the rate of major raw materials, power and fuel etc. in terms of rate per unit as compared to previous year, if any.

(V) He has to give details of wages and salaries including direct labour cost per unit of output and as compared to the previous year.

(VI) He has to indicate the amount of overheads along with reasons for any significant variations in expenditure incurred against the items of factory, administration, selling and distribution overheads as compared with previous two years.

(VII)The cost auditor has also to mention any abnormal feature affecting the production indicating their effect on the unit cost of production. Again the cost auditor may offer suggestions as regard the following matters for improvements in performance of the company under audit with reference to:-

(i) Rectification of general imbalance in production facilities
(ii) Fuller utilization of installed capacity
(iii) Concentration on areas offering scope for cost reduction, increased productivity and key limiting factors causing production bottlenecks; and
(iv) Suggesting improved inventory policies As far as possible data for the earlier years has to be furnished. The cost auditor could also interpret the data from the trend for the earlier years, and offer suggestions. The opinions shall be based on verified

data, reference to which shall be made and shall be included after the company has been given an opportunity to comment on items.

**3. (a) As a part of management strategy SEASENA LTD. manufacturing soaps, purchased a popular soap brand "SUNFLOWER" from a smaller company. What will be treatment of such costs and the disclosure to be made in the Cost Statements as per relevant Cost Accounting Standard. [10]**

**(b) "Operational Auditing is an extension of Internal Audit in operational areas but with different approach". Examine this statement in the light of the objectives of operational audit. [6]**

**Answers:**

**3(a)** The expenses paid or incurred for purchase of a brand is lump-sum in nature and purchased for the increase in revenue income over a long period of time. As per Cost Accounting Standard 10, expenses which are in the nature of 'one - time' payment, shall be amortized on the basis of the estimated output or benefit to be derived from such direct expenses. The expenses for which the benefit is ensued in the future period shall be equated with the estimated production/service volumes for the effective period and based on volume achieved during the Cost Accounting period. Accordingly, the charge for amortization shall be determined. In the given situation, the company is likely to be benefitted from the brand image of the product and the costs so amortized be treated as Selling Expenses over the estimated life of the brand image.

As per cas-10, the cost statements on direct expenses shall normally disclose the following:

1. The basis of distribution of Direct Expenses to the cost objects/cost units.
2. Quantity and rates of items of Direct Expenses, as applicable.
3. Where Direct Expenses are accounted at standard cost, the price and usage variances.
4. Direct expenses paid/payable to related parties.
5. Direct Expenses incurred in foreign exchange.
6. Any subsidy/Grant/incentive/credit/recoveries and any such payment be reduced from Direct Expenses.

Disclosure shall be made only where expenses are material, significant and quantifiable and be made in the body of the Cost Statement or as a foot note or as a separate schedule.

**3(b)** Operational auditing is review of operational methods and procedures. To that extent it is no more than internal audit extended to operational areas. However, as applied to operational areas the attempt must be not only evaluate controls, but also assess the effectiveness of existing procedures to meet the objectives and plans of the department which is being audited.

The objectives of operational audit may be briefly listed as appraisal of the relevant departments.

- Objectives and plans
- Controls.
- Existing procedures to achieve the objectives and plans.
- Quantitative measures to monitor of performance.
- Productivity

Since operating departments would be structuring their methods and procedures based on their objectives and plans, such objectives and plans have to be appraised.

Restatement or changes in definitions of the objectives could have an impact on the plans and similar change in plans may make it advisable to redefine the objectives. Hence appraisal of plans and objectives becomes essential and the first step in operational audit.

The procedure in the department has to be reviewed and appraised to assess their effectiveness in achieving the objectives and plans with the given resources.

It is necessary that every department should develop a few quantitative measures to monitor their performance. Such measures may be in simple or composite units. The trend of such measures, the usefulness of such indicators as well as their reliability may have to be appraised as part of operational auditing. Appraisal of productivity could be complex as the term 'Productivity' is all embracing and covers the effectiveness of entire operations of the concerned department.

**4. (a) Basic pay ₹ 5,00,000; Lease rent paid for accommodation provided to an employee ₹ 2,00,000, amount recovered from employee ₹ 40,000. Employer's Contribution to P.F. ₹ 75,000, Employee's Contribution to P.F. ₹ 75,000; Reimbursement of Medical expenses ₹ 67,000; Hospitalisation expenses of employee's family member borne by the employer ₹ 19,000, Festival Bonus ₹ 20,000; Festival Advance ₹ 30,000. Compute the Employee Cost. [6]**

**(b) PARTHAN CO. LTD. a single product manufacturing company, has following four operations undergone by a product under Cost Audit. The Processwise Input, Output, Direct Employee Costs and Direct Material Costs for the year ended March 31,2016 are given below: [10]**

| Process | Input Units | Output Units | Direct Employee Costs (Amt in ₹) | Direct Material Cost (Amt in ₹) |
|---|---|---|---|---|
| MP-1 | 312000 | 280800 | 8,42,400 | 11,23,200 |
| MP-2 | 330000 | 297500 | 11,90,000 | 13,38,750 |
| MP-3 | 414000 | 397500 | 19,87,500 | 16,89,375 |
| MP-4 | 390000 | 361000 | 28,88,000 | 23,82,600 |

**You are required to calculate:**
**a) Direct Employee Cost per unit of the product b) Direct Material Cost per unit of the product, -- under reference as required in (PART-B, PARA-2) of the Annexure to Cost Audit Report under the Companies (Cost Records and Audit) Rules,2014.**

**Answers**

**4(a)** Computation of employee cost

| Particulars | Amount (₹) |
|---|---|
| Basic pay | 5,00,000 |
| Add: Net cost to employer towards lease rent paid for accommodation provided to an employee = [2,00,000 – 40,000] | 1,60,000 |
| Add: Employers contribution to P.F | 75,000 |
| Add: Re-imbursement of Medical expenses | 67,000 |
| Add: Hospitalization expenses of employees family member paid by the employer | 19,000 |
| Add: Festival bonus | 20,000 |
| Employee cost | 8,41,000 |

**4(b)** Total employee cost per unit and total material cost per unit of the product under Audit mist be an aggregation of processwise employee cost and material costs after taking into account the good units occurring in each process.

| Process | Input(unit) | Output (unit) | Factor |
|---|---|---|---|
| Mp-1 | 312000 | 280800 | 312000÷280800=1.1111 |
| MP-2 | 330000 | 297500 | 330000÷297500=1.1092 |
| MP-3 | 414000 | 397500 | 414000÷397500=1.0415 |
| MP-4 | 390000 | 361000 | 390000÷361000=1.0803 |

| A) Processwise Employee costs per unit of output ( Product) are: | B) Processwise material cost per unit of output (product) are: |
|---|---|
| MP-1= 842400÷280800= ₹3 | 1123200÷280800= ₹4.00 |
| MP-2= 1190000÷297500= ₹4 | 1338750÷297500= ₹4.50 |
| MP-3= 1987500÷397500= ₹5 | 1689375÷397500= ₹4.25 |
| MP-4= 2888000÷361000= ₹8 | 2382600÷361000= ₹6.60 |

(i) Aggregating all above (A) employee cost to the finished product form process MP-4 will be:

| | | |
|---|---|---|
| Process MP-1 | = ₹3.00 | |
| Process MP-2 | = ₹3×1.1092+4 | = ₹7.3276 |
| Process MP-3 | = ₹7.3276×1.0415+5 | = ₹12.6317 |
| Process MP-4 | = ₹12.6317×1.0803+8 | = ₹21.6460 |

Direct employees cost per unit of finished product (output) in ₹21.65

(ii) Aggregating all above (B), material costs to the finished product from process MP-4 will be:

| | | |
|---|---|---|
| Process MP-1 | = ₹4.0000 | |
| Process MP-2 | = ₹4.00×1.1092+4.50 | = ₹8.9368 |
| Process MP-3 | = ₹8.9368×1.0415+4.25 | = ₹13.5577 |
| Process MP-4 | = ₹13.5577×1.0803+6.60 | = ₹21.2464 |

Hence, Direct material cost per unit of finished product (output) is ₹21.25

**5. The following is the abridged Balance Sheet of Apple Ltd., a single product manufacturing Company:**

| **Year ended 31st March,** | **2016** | **2015** |
|---|---|---|
| **Liabilities:** | **(Amount in ₹ lakhs)** | |
| **Share Capital** | **600** | **600** |
| **Reserves & Surplus:** | | |
| **Debenture Redemption Reserve** | **50** | **60** |
| **Capital Subsidy from State Government** | **60** | **60** |
| **Revaluation Reserve** | **250** | **280** |
| **General Reserve** | **320** | **240** |
| **Profit & Loss A/c** | **96** | **64** |

| | | |
|---|---|---|
| Secured Loans: | 550 | 590 |
| Unsecured Loans: | 246 | 234 |
| Total: | 2172 | 2128 |
| Assets: | | |
| Gross Block | 1450 | 1360 |
| Accumulated Depreciation | (630) | (580) |
| Net Block | 820 | 780 |
| Capital Work-in-Progress | 86 | 74 |
| Investments: | 30 | 30 |
| Current Assets: Loans & Advances: | | |
| Inventories | 934 | 882 |
| Sundry Debtors | 364 | 390 |
| Advances for Equipments | 48 | 34 |
| Other Loans & Advances | 288 | 274 |
| Cash and Bank Balances | 42 | 38 |
| Current Liabilities & Provisions: | | |
| Sundry Creditors for Capital expenses | (34) | (42) |
| Sundry Creditors for Others | (370) | (394) |
| Provision for Taxes | (128) | (142) |
| Miscellaneous Expenditure | 192 | 204 |
| Total: | 2172 | 2128 |

**Additional information is available:**

i) **Term Loans repayable in 12 months included under 'Secured Loans' are ₹ 192 lakh (previous year ₹168 lakh)**
ii) **Profit before Tax (PBT) for the year ended March 31st, 2016 is ₹ 160 lakh (previous year ₹ 174 lakh)**

**You are required to compute the following figures/ratios as Annexure to Cost Audit to Cost Audit Report under Companies (Cost Audit Report) Rules 2014, for the year ended March, 31, 2016:**

**(i) Capital Employed**
**(ii) Net Worth**
**(iii) Debt – Equity Ratio**
**(iv) PBT to Capital Employed**

**(v) PBT to Net Worth** **[16]**

**Answer:**

**5.** (i) Capital Employed

In ₹ lakh

| | | | 2016 | 2015 |
|---|---|---|---|---|
| Gross block | | | 1450 | 1360 |
| Less Depreciation | | | (630) | (580) |
| Net Block | | | 820 | 780 |
| Less Revaluation Reserve | | | 250 | 280 |
| Net Fixed Assets | | | 570 | 500 |
| Current Assets (A) | | | | |
| Inventories | 934 | 882 | | |
| Sundry Debtors | 364 | 390 | | |
| Loans & Advances | 288 | 274 | | |
| Cash and Bank | 42 | 38 | | |
| | 1,628 | 1,584 | | |
| Current Liabilities (B) | | | | |
| Creditors (others) | 370 | 394 | | |
| Prov. For Taxes | 128 | 142 | | |
| Term Loan (due in 12 months) | 192 | 168 | | |
| | 690 | 704 | | |
| Net Working capital (A) – (B) | | | 938 | 880 |
| Capital Employed | | | 1508 | 1380 |

Average Capital Employed (1508 + 1380)/2 = ₹ 1444 lakhs

(ii) Net Worth

| | 2016 (₹ lakh) |
|---|---|
| Share capital | 600 |
| Debentures Redemption reserve | 50 |
| Capital Subsidy | 60 |
| General Reserve | 320 |
| Profit and Loss A/c | 96 |
| | 1126 |
| Less: Miscellaneous Expenses | 192 |
| | 934 |

(iii) Debt – Equity ratio

| | |
|---|---|
| Secured Loans | 550 |
| Unsecured Loans | 246 |
| | 796 |
| Less Due in 12 months | 192 |
| | 604 |

Ratio = 604/1126 × 100 = 53.64% or 0.5364:1

(iv) PBT to capital Employed (160/1444) × 100 = 11.08%

(v) PBT to Net worth (160/934) × 100 = 17.13%

**6. (a) The Financial profit and loss account for the year 2015-16 of a company shows a net profit of ₹ 26,28,000. During the course of cost audit, it was noticed that**

**i) The company was engaged in trading activity by purchasing goods at ₹4,00,000 and selling it for ₹5,00,000 after incurring an expenditure of ₹25,000**
**ii) Some old assets sold off at the end and fetching a profit of ₹ 80,000**
**iii) A major overhaul of machinery was carried out at a cost of ₹4,00,000. And the next such overhaul will be done only after four years.**
**iv) Interest was received amounting to ₹1,50,000 from outside investments.**
**v) Work-in-progress valuation for financial accounts does not as a practice take into account factory overhead. Factory overhead was ₹ 1,85,000 in opening WIP and ₹ 3,15,000 in closing WIP.**

**Compute profit as per Cost Accounts and briefly explain the adjustment, if any, carried out. [6]**

**(b) From the following figures extracted from the accounting records, you are required to compute the Valued Added by the company:**

| | ₹ Lakhs |
|---|---|
| Net Sales excluding excise duty | 21,000 |
| Increase in stock of finished goods | 250 |
| Expenses: | |
| Raw materials consumed | 2,600 |
| Packing materials consumed | 1,200 |
| Stores and spares consumed | 550 |
| Power and fuel | 4,600 |
| Repairs and maintenance | 200 |
| Insurance | 120 |
| Direct Salaries and wages | 480 |
| Depreciation | 885 |
| Interest paid | 1,398 |
| Factory overheads: | |
| Salaries and wages | 240 |
| Others | 250 |
| Selling and distribution overheads: | |
| Salaries and wages | 120 |
| Additional sales tax | 457 |
| Others | 1,700 |
| Administration overheads: | |
| Salaries & wages | 120 |
| Others | 80 |

**[10]**

**Answers:**

**6. (a)** Statement Showing Reconciliation of Profit:

| Particulars | Amount | Amount |
|---|---|---|
| Profit (loss) as per financial accounts | | 26,28,000 |
| Less: Amount of incomes not considered in cost accounts | | |
| Trading on sale of assets | -75,000 | |
| Profit on sale of old assets | -80,000 | |

| | | |
|---|---|---|
| Interest received on outside investment | -1,50,000 | -3,05,000 |
| Add: Amount of expenses not considered in cost accounts<br>Overhauling charges (3/4 not provided in cost accounts)<br>Depreciation provided on revaluation of assets | <br><br>3,00,000<br><br>2,25,000 | <br><br><br><br>5,25,000 |
| Difference in stock valuation as per cost & financial records<br>Add: difference in valuation of WIP | | <br><br>1,30,000 |
| Total profit (loss) as per cost accounts | | 29,78,000 |

**(b)**

| Particulars | | ₹ Lakhs |
|---|---|---|
| Computation of value added:<br>Net sales + increase in stock of finished goods | | <br>21,250 |
| Less: cost of bought out goods & services:<br>Raw materials<br>Packing materials<br>Stores and spares<br>Power and fuel<br>Repairs and maintenance<br>Insurance<br>Other factory overhead<br>Other selling and distribution overhead<br>Other administration overheads | <br>2600<br>1200<br>550<br>4600<br>200<br>120<br>250<br>1700<br>80 | <br><br><br><br><br><br><br><br><br>11,300 |
| Value added: | | 9,950 |
| Composition of value added:<br>Depreciation<br>Interest<br>Additional sales tax.<br>Salaries & wages<br>Profit before tax | | <br>885<br>1398<br>457<br>960<br>6250 |
| Total | | 9950 |

**7. (a) The following data were extracted from the departmental data of Cost centre where A and B were employed and performing the job X, Y and Z.**

| | | | |
|---|---|---|---|
| **1** | **Basic wages** | **₹ 150** | **₹ 210** |
| **2** | **Dearness Allowances** | **80%** | **80%** |
| **3** | **Contribution to Provident fund on Basic wages** | **10%** | **10%** |
| **4** | **Contribution to ESI on Basic wages** | **4%** | **4%** |
| **5** | **Overtime** | **18 hours** | **Nil** |

**The normal working hours per month is 200 hours. Overtime is paid at double the rate of normal wages ad dearness allowance. Employers contribution to Provident fund and ESI are at equal the rate of employees contribution. The two workers are employed on jobs X, Y and Z in the following proportion:**

| Jobs | X | Z |
|---|---|---|
| Worker A | 30% | 40% |
| Worker B | 20% | 50% |

**Overtime was done by A for job Y.**
**From the above**

**a) Calculate the earnings of A and B for a month to show labour rate per hour**
**b) Allocate the labour cost to each job X, Y and Z. [10]**

**(b) A company has units in SEZ and in non-SEZ areas. The Companies (Cost Records and Audit) Rules 2014 has exempted companies operating in special economic zones from cost audit.What would be applicability of the Companies (Cost Records and Audit) Rules 2014 on such a company in respect of maintenance of cost accounting records and cost audit? [6]**

**Answers**

**7(a).(a)** Calculation of overtime wages of A:

| | ₹ |
|---|---|
| Basic wages | 150.00 |
| Dearness allowance (80% of ₹ 150) | 120.00 |
| Total Wages | 270.00 |
| Wage rate per hour (270/200) | 1.35 |
| Overtime wages [18 hrs × (1.35 × 2)] | 48.60 |

Computation of total earnings of A and B:

| Particulars | A (`) | | B (`) |
|---|---|---|---|
| Basic wages | | 150.00 | 210.00 |
| Dearness Allowance ( 80% of Basic) | | 120.00 | 168.00 |
| Overtime Wages | | 48.60 | |
| Gross wages earned | | 318.60 | 378.00 |
| Less: P.F @ 10% of Basic | | 15.00 | 21.00 |
| E.S.I. @ 4% of Basic | | 6.00 | 8.40 |
| Net wages earned | | 297.60 | 348.60 |

Computation of labour cost per hour:

| | A(₹) | B(₹) |
|---|---|---|
| Basic + Dearness Allowance | 270.00 | 378.00 |
| Add: Employers contribution to PF and ESI (@ 14% of basic) | 21.00 | 29.40 |
| | 291.00 | 407.40 |
| Labour rate per hour | 1.455 | 2.037 |

Statement showing allocation of wages to job:

| | Total (₹) | X (₹) | Y (₹) | Z (₹) |
|---|---|---|---|---|
| A's wages ( 3:3:4 ) | 291.00 | 87.30 | 87.30 | 116.40 |

| | | | | |
|---|---|---|---|---|
| A's overtime wages | 48.60 | - | 48.60 | - |
| B's wages ( 2:3:5 ) | 407.00 | 81.40 | 122.10 | 203.50 |
| Total | 746.60 | 168.70 | 258.00 | 319.50 |

**7(b)** Rule 3 of the Companies (Cost Records and Audit) Rules 2014 is specific and it has mandated maintenance of cost accounting records on all products/activities listed under Table-A and Table-B subject to threshold limits. No exemption is available to any company from maintenance of cost accounting records once it meets the threshold limits. Hence, the above company would be required to maintain cost accounting records for all its units including the one located in the special economic zone.

In view of the provisions of Rule 4(3) (ii) of the Companies (Cost Records and Audit) Rules 2014 the unit located in the Special Economic Zone (SEZ) would be outside the purview of cost audit and the company would not be required to include particulars of such unit in its cost audit report. The other units of the company located outside the special economic zone would be covered under Cost Audit subject to the prescribed threshold limits.

**8.(a) Analyze the role of Internal Auditor in the internal control system of the organization. [6]**

**(b) The Companies (Cost Records and Audit) Rules, 2014 requires submission of a Single Cost Audit Report at the company level. What is the procedure of certifying and submission of Cost Audit Report of a company where more than one Cost Auditor is appointed? [5]**

**(c) Explain the features of a good internal control system. [5]**

**Answers:**

**8(a)** The primary objectives of internal control are to ensure-

i. Reliability and integrity of information
ii. Compliance with policies, plans, procedures, laws and regulations.
iii. The safeguarding of assets.
iv. The economical and efficient use of resources.
v. The accomplishment of established objectives and goals of operation or programme.

The management is usually on the lookout for someone who can assure them that control systems implemented-are being followed and- periodically reviewed/ cross checked for their suitability vis-à-vis adaptability-to-changing circumstances, so that management can earn confidence is managing the business in the desired direction. Then, the question arises as to the scope of appraisal by the internal auditor to aid management is keeping up confidence in running a business and in achieving organizational objectives. The internal auditor is to go beyond the ambit of control measures determine by appraising and assessing the extent of implementation of the management control systems, ensuring as well as assuring the management control systems are as effective as these are expected to be and thereby converting hopes and aspirations of the organization into reality and accomplishments.

Internal auditing, as has been seen, can therefore reveal a sound internal control system but nevertheless the support of the top and middle management is a must. The Audit committee as elaborated in the Companies Act, 2013 directs evaluation of internal controls and risk management systems. Since control mechanism operates through men only, the human side of the enterprise is to be relied on for efficient of control functions. The Committee is to hold discussion with internal auditors of any significant findings and follow up there on about the failure of internal control system.

**(b)** In case of a company having more than one cost auditor, it would be necessary for the company to appoint/designate one cost auditor as the lead cost auditor for consolidation of the report.

The individual cost auditors appointed for specific units/products would be required to audit and provide para numbers A-4, B – 1, B-2, B-2A, B-2B, B-2C, C-1, C – 2, C-2A, C-2B, C-2C (as applicable), D-1 in respect of the products/services coming under the purview of their respective audits. The individual auditors would also be required to submit to the Board of Directors the individual cost audit report as per Form of the Cost Audit Report given in CRA-3.

The lead auditor would be responsible for preparing the Para number A-3, D-2, D-3, D-4, D-5, D-6 and consolidate Para numbers A-4, B-1, B-2, B-2A, B-2B, B-2C, C-1, C-2, C-2A, C-2B, C-2C( as applicable), D-1 received from the individual cost auditors.

The consolidated report should contain the reports of all the individual cost auditors including the report of the lead cost auditor. In case individual cost auditors have any observations or suggestions or qualifications, they would be required to mention the same under Para 2 of the cost audit report and the lead auditor would have to mention the specific observations and/or qualifications of all the individual cost auditors in the place provided for the same in the under Para-A-1.

The consolidated report so prepared would be converted to XBRL and submitted to the Central Government by the Company in Form CRA-4.

**8(c)** A good internal control system should possess the following feature:-

1. Proper organization structure:
   (A) A good internal control system should involve segregation of duties in such a manner that error or fraud cannot take place.
   (B) Proper division of duties, with respect to access to assets, authorization of transaction, execution of transactions and record keeping should be based on the organization structure.

1. Scheme of authorization and procedures: A good internal control System should define proper authorizations and procedures. The scheme of authorization should ensure that-
   (A) Every transaction is duly authorized by the competent official
   (B) Every transaction is properly accounted in the books, and
   (C) Supervisory procedures are laid down based on the responsibilities of each official.

2. Internal Check:
   (A) Accounting procedures should be designed in such a manner that no single person is authorized to carry out all the operations involved in a transaction.
   (B) The system should institute a prompt and independent verification of an individual's work by prescribing cross-checks and cross-reconciliations as a part of the operating procedure itself and also provide for complimentary allocation of duties.

3. Suitable personnel:
   (A) Competent and honest persons alone should be employed in the organization so that the system operates effectively.
   (B) The qualification, experience and personal characteristics of the personnel involved are important in establishing and maintaining a system of internal control.

4. Internal Audit System
   (A) The Management may establish an internal Audit Department and delegate some of its supervisory functions like review of internal control.
   (B) Internal Audit constitutes a separate component of internal control system undertaken by specially assigned staff with the objective of determining whether internal controls are well designed and operating properly.