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.

Section A (All questions are compulsory.)

1. Choose the correct option among four alternative answer. (1 mark for correct choice, 1 mark for justification.) [10*2=20 marks]

(i) Normal capacity is :
(A) Maximum production capacity of a plant.
(B) Difference between installed capacity and actual capacity utilization
(C) Volume of production achieved or achievable on an average over a period under normal circumstances
(D) Installed capacity minus inevitable interruptions.

(ii) CAS 20 deals with:
(A) Joint Costs
(B) Royalty and Technical Knowhow fee
(C) Research and Development Costs
(D) Interest and Financing charges.

(iii) Under Part D of the Annexure to the Cost Audit Report, information regarding Profit Reconciliation (for company as a whole) to be furnished for:

(A) Previous year only.
(B) Current year and previous 2 years.
(C) Current year and previous year.
(D) Previous three years.

(iv) Part C of the annexure to Cost Audit Report provides Abridged Cost Statement related to:
(A) Manufacturing Sector
(B) Service Sector
(C) None of the above
(D) Both of the above

(v) Cost Auditor's observation and suggestions are given in
(A) CRA-3
(B) CRA -2
(C) CRA-1
(D) Annexure

(vi) Position Analysis is one of the techniques used by Management Auditor for evaluation of:
(A) Profit of a Corporate.
(B) Networth of a Corporate.
(C) Balance Sheet of a Corporate.
(D) Corporate image.

(vii) Under 'propriety audit' the auditors try to bring out cases of :
(A) Improper expenditure
(B) Avoidable or infructuous expenditure
(C) Both A & B
(D) None of the above.

(viii) Cost Auditing Standard 102 deals with:
(A) Planning an Audit of Cost Statements
(B) Cost Audit Documentation
(C) Overall Objectives of the Independent Cost Auditor and Conduct of an Audit in Accordance with Cost Auditing Standards
(D) Knowledge of Business, Its processes and the Business Environment

(ix) Internal Audit is applicable to every --------------company.
(A) unlisted
(B) listed
(C) Both A& B
(D) None of above is correct.

(x) Co-operative auditor to conduct an examination of :
(A) prepaid expenses
(B) income received in advance
(C) overdue debts
(D) unpaid expenses.

Answer: 1

(i) (C) Volume of production achieved or achievable on an average over a period under normal circumstances. This is as per CAS 2 on "Capacity Determination".

(ii) (B) Royalty and Technical Knowhow fee.

This standard deals with the principles and methods of determining the amount of Royalty and technical Know-how Fee.

(iii) (C) Current year and previous year. Companies(Cost Records and Audit) , Rules 2014 prescribes this format of information for Profit Reconciliation.

(iv) (B) Service Sector. This is as per format prescribed by Companies(Cost Records and Audit) Rules, 2014.

(v) (A) CRA-3. . This is as per format prescribed by Companies(Cost Records and Audit) Rules, 2014.

(vi) (D) Corporate image. Position Analysis helps in determining market share, market stability , etc.

(vii) (C) Both A & B**.** Under 'propriety audit', in context of Government Audit the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations.

(viii) (B) Cost Audit Documentation. The purpose of this standard is to provide guidance to the members in preparation of audit documentation in the context of the audit of cost statements, records and other related documents.

(ix) (B) listed. As per Rule 13 of Companies(Accounts) Rules, 2014.

(x) (C) overdue debts. Section 17 (2) of the Co-operative Societies Act, 1912 specifically requires the auditor to conduct an examination of the overdue debts, if any, and a valuation of the assets and liabilities of the society.

Section B (Answer any 5 questions from this section)[80 marks]

2 (a) Answer the following questions with respect to Companies (Cost Records and Audit) Rules, 2014.

(i) Whether Value addition and distribution of earnings [part D, para 3] is to be computed based on Cost record data or audited financial data?

(ii) Whether Financial position and ratio analysis [part D, para 4] is to be computed based on Cost record data or audited financial data?

(iii) A Company is engaged in both regulated and Non-regulated sectors and all its products are not covered under the rules. How to determine applicability of cost audit for the products covered under the regulated and Non-regulated sectors since different threshold limits have been prescribed under rule 4? [1+1+6]

2 (b) Which of the following acts amount to professional misconduct on part of a practicing CMA?

(i) X, a CMA gives a certificate of Cost Of Production for attaching with a tender for a cost plus contract. He comes to know after signing the certificate that his client has won a case with a supplier on account of which the client is entitled to get a refund of substantial portion of the purchase price of the raw material. The certificate is not corrected.

(ii) Y is a shareholder in PQ Ltd. holding 100 shares. The company 's paid up capital is ₹5 crores (50 lac shares of ₹10 each). X accepts a certificate work from the company.

[4+4]

Answer: 2

2 (a) (i) Value Addition statement is to be computed based on audited financial accounts.

(ii) Financial Position and Ratio Analysis is to be computed based on audited financial accounts. This reporting Para has been aligned with the nomenclature of Schedule III of the Companies Act, 2013.

(iii) Rule 4 states that cost audit would be applicable for products under:

(a) Table A if the overall turnover of the company is at least ₹ 50 crore and

(b) Table B if the overall turnover of the company is ₹ 100 crore.

Hence, the coverage of cost audit for a company where all its products are covered under Table A or Table B or a combination of the two would be guided by these threshold limits.

In case of a multi-product company where all its products are not covered under Table A or Table B or a combination of both, then the following would apply:

(a) if the overall turnover of the company is more than ₹ 50 crore but less than ₹100 crore, then only products covered under Table-A will be covered under cost audit provided the sum total of all the products of the company covered under Table A and Table B is more than ₹ 25 crore.

(b) If the overall turnover of the company is more than ₹100 crore, then:

(i) products under both Table A and Table B will be covered under cost audit provided the sum total of all the products of the company covered under Table A and Table B is more than ₹ 35 crore

(ii) only products of table a will be covered if the sum total of all the products of the company covered under Table A and Table B is more than ₹ 25 crore but less than ₹ 35 crore.

Explanation: Rule 4 has defined threshold limits for Table A and Table B separately but the aggregate turnover of the individual product or products or service or services has been defined to be all products for which cost records are required to be maintained under rule 3.

2 (b) According to second schedule of the Cost and Works Accountants Act 1959, Part 1 Clause 5, a practicing CMA is guilty of professional misconduct if he fails to disclose a material fact known to him in a cost or pricing statement, which is not disclosed in a cost or pricing statement but disclosure of which is necessary in making such statement where he is concerned with such statement in a professional capacity;
In the case although at the time of signing certificate , the cost of materials was based on the accounts and documents made available to the CMA, if he was aware of the pending litigation, he should have qualified his report as such. Otherwise , it would amount to misconduct.
On other habd if the CMA was kept in dark about the litigation by the client, he should have issued a corrigendum to the certificate immediately after he comes to know of the judgment.

ii) According to second schedule of the Cost and Works Accountants Act 1959, Part 1 Clause 4, a practicing CMA is guilty of professional misconduct if expresses his opinion on cost or pricing statements of any business or enterprise in which he, his firm or a partner in his firm has a substantial interest;
In the case , Y does not have substantial interest in PQ Ltd. And hence his undertaking the certification work does not amount to misconduct.

3 (a) How would you treat the following as per CAS-11 related to Administrative Overheads?
(i) Leased Assets
(ii) Cost of Administrative Services procured from outside
(iii) Cost of Software
(iv) Fines. [8marks]

(b) The Cost Accountant of TRINCUS TEXTILES MILLS LTD. has arrived at a Profit of ₹ 20,10,500 based on Cost Accounting Records for the year ended March 31, 2015. Profit as per Financial Accounts is ₹22,14,100.

As a Cost Auditor, you find the following differences between the Financial Accounts and Cost Accounts:

		₹
(1)	Profit on Sale of Fixed Assets	2,05,000
(2)	Loss on Sale of Investments	33,600
(3)	Voluntary Retirement Compensation included in Salary & Wages in F/A	50,25,000
(4)	Donation Paid	75,000
(5)	Insurance Claim relating to previous year received during the year	5,08,700
(6)	Profit from Retail trading activity	32,02,430
(7)	Interest Income from Inter-Corporate Deposits	6,15,000
(8)	Decrease in value of Closing WIP and Finished goods inventory	
	as per Financial Accounts	3,82,06,430
	as per Cost Accounts	3,90,12,500

You are required to prepare a Reconciliation Statement between the two Accounts for the year ended March 31, 2017. [8 marks]

Answers: 3

3 (a)(i) In case of leased assets, if the lease is an operating lease, the entire rentals shall be included in the administrative overhead. If he lease is a financial lease, the financial cost portion segregated and treated as finance cost.

(ii) Cost of administrative services procured from outside shall be determined at invoice or agreed price including taxes and duties. And other expenditure directly attributable there to net of discounts and other cash discount taxes and duties refundable or to be credited.

(iii) The cost of software (developed in house, purchased, licensed or customized) including up gradation cost shall be amortized over the estimated useful life.

(iv) Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the administrative overheads.

3 (b) RECONCILIATION OF PROFIT BETWEEN COST AND FINANCIAL ACCOUNTS FOR THE YEAR ENDED MARCH 31. 2017

	₹	₹
Profit as per Financial Accounts:		22,14,100
Add: Loss on sale of investments	33,600	
Add: Voluntary Retirement compensation included in salary	50,25,000	
and wages in F/A - Not included in cost A/c	75,000	51,33,600
Add: Donation paid		73,47,700
Less: Profit on Sale of Fixed Assets-Not considered in cost A/c	2,05,000	
Less: Receipts of insurance claim related to previous year	5,08,700	
Less: Profit from Retail trading activity	32,02,430	
Less: Interest income from inter-corporate deposit-not considered in cost accounts	6,15,000	
Less: Difference in valuation of stock:		
Decrease in inventories as per cost accounts 3,90,12,500		
Decrease in inventories as per financial accounts 3,82,06,430	8,06,070	53,37,200
Profit as per Cost Accounts		20,10,500

4 (a) Mr . X , newly appointed CEO of ABC Ltd. engages you as a Management Auditor to give him a factual report , as to causes of demoralization of his staff . [8 marks]

4 (b) Write short note on - Probable format of environmental statement . [8 marks]

Answer: 4

4 (a) Report on demoralization of Employees:

The investigation reveals that by and large the employees of the organization are demoralized and dispirited. There is total absence of commitment and initiative on the part of employees. There is a growing discontentment among the employees. The factors responsible for grave demoralization amongst the employees are as follows:

i) Insufficient promotion opportunities : There is no system of 'Individual career growth plan'. Some employees are stagnant and are not getting promotion for long stretch of time. Such employees are totally frustrated and demoralized. A statement of employees stagnating for more than 6 years in the same post may be complied and reason may be looked for.
ii) Preference is given to Direct Recruitment over Internal Promotion. There is no management succession system and no system of 'potential spotting 'amongst employees. Neither the company is serious about training its Human Resources in their functional areas. Direct recruitment to senior staff position is resented to by the employees.
iii) There is considerable imbalance in workload and in overtime opportunities.
iv) There is a system of assignment of personnel to tasks that do not interest/ encourage them.
v) There is no 'Employee Participation' in management.
vi) The application of management concepts like 'job rotation' ,'job evaluation', 'merit rating' are totally absent in the organization.
vii) There is no scientific appraisal system. There is favourism and nepotism by the management.
viii) Apart from the above, the human aspects of personnel development viz. the programme of informal education, recreation and culture, community development etc. to enhance the quality of work life are totally neglected.
ix) here is no transfer policy and employees are transferred at the whims and fancies of the management.

So it can be concluded that company is pursuing wrong personnel policies and procedures, leading dissatisfied and demoralized employees.

4 (b) The following are the main aspects which may be covered in the probable format of Environmental Statement:

i. Name and address of the owner/occupier of the industry, operation or process.
ii. Date of last environmental audit report submitted.
iii. Consumption of water and other raw materials during current and previous year.
iv. Pollution generated in air and water alongwith the output and the types of pollutants and the deviation from standards.
v. Generation of hazardous waste in current year and previous year from processes.
vi. Quantity of solid waste generated during current year and previous year and from recycling or reutilisation of waste, etc.
vii. Disposal practice for different type of waste.
viii. Practice in operation for conservation of natural resources.
ix. Additional investment proposal for environmental protection including abatement of pollution.

5 (a) ABC Pvt. Ltd took a consortium loan in 2016-17 amounting to ₹90 crores of which State Bank of India is the leading Bank for setting up a new plant in Haldia. During the year 2015-16 its outstanding loan was ₹60 crores of which repayment was made in the year 2016-17 to the extent of ₹15 crores. Should ABC Pvt . Ltd conduct internal audit as per Companies Act 2013? [6 marks]

(b) As an internal auditor of DEF Ltd. the Managing Director has asked you to enquire into the causes of abnormal wastage of raw materials during the month of September, 2017.

The wastage percentages are as follows:

June, 2017	**1.3%**
July, 2017	**1.1%**
August, 2017	**1.4%**
September, 2017	**3.8%**

How will you proceed to carry out the Assignment? [10 marks]

Answer: 5

5 (a) Section 138 of the companies act 2013 deals with provisions of internal audit. Section 138 of the Companies Act 2013 read with Rule 13 - Companies(Accounts) Rules, 2014 states that the following class of companies shall be required to appoint an internal auditor or a firm of internal auditors, every private company having-

(i) turnover of two hundred crore rupees or more during the preceding financial year; **or**

(ii) Outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year:

Provided that an existing company covered under any of the above criteria shall comply with the requirements of section 138 and this rule within six months of commencement of such section.

Outstanding loan of ABC Pvt. Ltd is ₹135 crores as on 31st March 2017. So the Company is required to appoint internal auditor as per Companies Act 2013 read with Rule 13- Companies (Accounts) Rules, 2014.

5 (b) The rate of wastage in September, 2017 has risen sharply as compared to previous months. Under the circumstances, before setting for detailed investigation, the internal auditor need to understand the manufacturing environment right from the stage of purchase of materials, the movement of stock flow through the production process while its becomes finished goods. To locate the reasons for the abnormal wastage, the internal auditor should first of all assess the general requirements as under:

(i) Procure a list of raw materials, showing the names and detailed characteristics of each raw material.

(ii) Obtain the standard consumption figures, and ascertain the basis according to which normal wastage figures have been worked out. Examine the break up of a normal wastage into that in process, storage and handling stages. Also obtain control reports, if any, in respect of manufacturing costs with reference to predetermined standards.

(iii) Examine the various records maintained for recording separately the various lots purchased and identification of each lot with actual material consumption and for ascertaining actual wastage figures therein.

(iv) Obtain reports of Preventive Maintenance Programme of machinery to ensure that the quality of goods manufacture is not of sub-standard nature or leads to high scrap work.

(v) Assess whether personnel employed are properly trained and working efficiently.

(vi) See whether quality control techniques have been consistent or have undergone any change.

(vii) Examine inventory plans and procedures in report of transportation storage efficiency, deterioration, pilferage and whether the same are audited regularly.

(viii) Examine whether the basis adopted for calculating wastage for September is the same as was adopted for the other three months.

(ix) Obtain a statement showing break up of wastage figures in storage, handling and process for the four months under reference and compare the results of the analysis for each of the four months.

Some specific reasons for abnormal wastage in process specific may be considered by the auditor are as under:

(A) Examine laboratory reports and inspection reports to find out if raw materials purchased were of a poor quality or were of sub-standard quality. This will be most useful if it is possible to identify the wastage out of each lot that has been purchased.

(B) Machine breakdown, power failure, etc. may also result into loss of materials in process. Check the machine utilisation statements.

(C) A high rate of rejections in the finished lots may also be responsible for abnormal wastage; therefore, examine the inspectors' reports in respect of inspection carried out on the completion of each stage of work or process.

(D) It is possible that the wastage may have occurred because the particular lot out of which issues were made in September, 2011 was lying in the store for a long time, leading to deterioration in quality or because of a change in the weather which may have led to the deterioration. Compare the wastage figures of September, 2010 with those of September, 2011.

(E) Abnormal wastage in storage and handling may arise due to the following reasons:

(i) *Write offs on account of reconciliation of physical and book stocks*: In case of periodical physical stock taking, such write offs will be reflected only in the month such reconciliation takes place.

(ii) *Accidental, theft or fire losses in storage*: The auditor should examine the possibility of these for the purpose.

(F) Examine whether any new production line was taken up during the month in respect of which standard input-output ratio is yet to be set-up.

6. The following are the financial statements of KODIAC LTD. For the year ended March 31, 2017.

Balance Sheet as on March 31, 2017

(Amount in ₹ Lakh)

Equity & Liabilities	₹	Assets	₹
Shareholders' Fund:		Non-Current Assets:	
Equity share capital	560	Fixed Assets (Net)	2,100
Preference Share Capital	280	Goodwill	280
Reserves & Surplus:	560	Current Assets:	
Non-Current Liabilities:		Cash at bank	140
Long term debt	1,680	Trade Receivables	700
Current Liabilities:		Inventories	980

Trade Payables	840		
Outstanding Expenses	80		
Provision for tax	200		
	4,200		4,200

Profit and Loss Account for the year ended March 31, 2017

(Amount in ₹ Lakh)

Sales:	₹	₹
Cash		560
Credit		2,240
		2,800
Less: Expenses:		
Cost of goods sold	1,680	
Administrative, Selling and General Expenses	280	
Depreciation	196	
Interest on Long-term debt	84	2,240
Profit before Taxes		560
Taxes		280
		280
Less: Preference dividend		34
Net Profit for Equity shareholders		246
Add: Reserves at April 1, 2016		364
		610
Less: Dividend paid to Equity Shareholders		50
Reserves at March 31, 2017		560

The Ratios of Kodiac Ltd. For the years ended March 31 and their Industry Average ratios and are given below:

	2014-15	2015-16	2016-17	Industry Average 2016-17
Current Ratio	2.54	2.10		2.30
Acid-test Ratio	1.10	0.96		1.20
Debtors Turnover	6.00	4.80		7.00
Stock Turnover	3.80	3.05		3.85
Long-term Debt to total Capital	37%	42%		34%
Gross Profit margin	38%	41%		40%
Net Profit Margin	18%	16%		15%
Return on Equity	24%	29%		19%
Return on Total Assets	7%	6.8%		8%
Tangible Assets turnover	0.80	0.70		1.00
Interest Coverage	10	9		10

Required:

(1) Complete the financial Ratios Calculation for the year 2016-17.
(2) Analyse the financial performance of the company and
(3) Offer year suggestions to the management for improvements in performance.

(6+5+5)

Answer: 6

6 (a) (i)

KODIAC LTD.

Calculation of Ratios: **(Amount in ₹ Lakh)**

1	Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{140+700+980}{840+80+200} = \frac{1820}{1120}$	= 1.63
2	Acid-test Ratio	$\frac{\text{Liquid Assets}}{\text{Liquid Liabilities}} = \frac{\text{Current Assets - Stock}}{\text{Current Liabilities - Bank Overdraft}} = \frac{1820-980}{1120} = \frac{840}{1120}$	= 0.75
3	Debtors turnover	$\frac{\text{Net Credit Sales}}{\text{Average Accounts Receivable}} = \frac{2240}{700}$	= 3.20
4	Stock turnover	$\frac{\text{Cost of Goods Sold}}{\text{Average Inventory}} = \frac{1680}{980}$	= 1.71
5	Long-term debt to total capital	$\frac{\text{Long Term Debt}}{\text{Share Holder's Equity + Debt}} = \frac{1680}{560+560+1680} = \frac{1680}{2800}$	= 60%
6	Gross Profit Margin	$\frac{\text{Revenue - Cost of Goods Sold}}{\text{Revenue}} = \frac{2800-1680}{2800}$	= 40%
7	Net Profit Margin	$\frac{\text{Net Profit}}{\text{Revenue}} = \frac{280}{2800}$	=10%
8	Return on equity	$\frac{\text{Net Income}}{\text{Share Holder's Equity}} = \frac{246}{560+560} = \frac{246}{1120}$	= 21.96%
9	Return on total Assets	$\frac{\text{EBIT (Net Income + Interest + Taxes)}}{\text{Total Net Assets - Goodwill}} = \frac{560+84}{4200-280} = \frac{644}{3920}$	=16.43%
10	Tangible Assets Turnover	$\frac{\text{Total Turnover}}{\text{Tangible Assets}} = \frac{2800}{4200-280}$	= 0.71
11	Interest coverage	$\frac{\text{EBIT}}{\text{Interest}} = \frac{560+84}{84}$	= 7.67

* Value of Intangible assets is excluded:

(ii) Evaluation of Financial Performance of the company.

(1) Liquidity position of the company is falling and is lower than industry's average which is evident from ratios (SL. No. 1 to 4).

(2) The gross profit margin is constant and matches with the industry average. (SL. No. 6 of ratio) but net profit margin ratio (SL. No. 7) is declining and lower than the industry average. The ratios together imply that the company's selling and administrative expenses, depreciation and interest charges are rising.

(3) The decline in the net margin is partly due to rapid increase in debt (SL. No.5) which is substantially higher than industry average. This increase also explains why the return on equity ratio (SL. No. 8) has been rising while the return on total assets ratio is increasing which is higher than the industry average (SL. No. 9). The decline in the net margin can be attributed to the decline in assets turnover Ratio (SL.No.10).

The impact of the increase in debt and overall decline in profitability are also shown by reduction in the interest coverage ratio (SL. No.11) which is lower than the industry average. So, overall financial performance of the Company is not sound or impressive.

(iii) Suggestions:

The Management is advised to:

(i) Increase production so that cost of production can be cut.

(ii) Reduce long term debt so that interest burden can be declined.

(iii) Take steps to arrest declining trends in both the solvency ratios positions.

(iv) Reduce selling and sales promotion expenses and Administrative expenses.

(v) Improve the efficiency of inventory management.

(vi) Prompt debt collection to increase liquid fund.

(vii) Take steps for arresting the slow -moving and non-moving inventory.

(viii) Finance from long term funds for core current assets according to Principles of sound financial management.

(ix) Take remedial measure to use optimum capacity in future.

7 (a) The following are condensed comparative financial statement of KBC LTD., a single product manufacturing company for three years ended 31st March, 2017, 2016 and 2015.

(Amount in ₹ Lakh)

Equity & Liabilities	2017	2016	2015
Shareholders' Fund:			
Equity Share Capital	3,000	2,000	2,000
Reserves and Surplus	4,360	3,250	2,440
Non-Current Liabilities:			
Term Loans	3,080	1,650	1,500
Debentures	1,600	1,600	1,600
Other Long-term Loans	1,200	1,500	1,400
Current Liabilities:			
Current Liabilities	2,660	1,252	1,720
Short term Provisions	800	600	500
Total	16,700	11,852	11,160
Assets			
Non-Current Assets:			
Fixed Assets:			
Tangible Assets	4,066	3,808	3,600
Intangible Assets	---	---	---
Capital Work in Progress	1,704	---	---
Non-Current Investments:			
Investment in subsidiaries	800	400	400
Current Assets:			
Inventories	4,030	2,490	2,320
Trade Receivables	4,810	3300	3,040
Cash and Cash equivalents	610	404	760
Short term Loans and Advances	680	1,450	1,040
Total	16,700	11,852	11,160

Profit and Loss Account for the year ended March 31.	2017	2016
	(Amount in ₹ Lakh)	
Income:		
Revenue (including excise duty) from Operations	29,040	24,510

Expenditure:		
Material consumed	**11,340**	**9,008**
Excise duty on despatches	**6,690**	**6,852**
Employee Costs	**1,650**	**1,380**
Other Manufacturing expenses	**1,100**	**960**
Selling and distribution expenses	**3,102**	**2,802**
Administration expenses	**500**	**460**
Interest on:		
Term Loans	**692**	**402**
Debentures	**240**	**240**
Other long term loans	**160**	**200**
Depreciation	**604**	**400**
Difference in Stock	**1,652**	**536**
	27,730	**23,240**
Profit before Taxation (PBT)	**1,310**	**1,270**
Provisions for Taxation	**200**	**460**
Profit After Taxation (PAT) (Transferred to Balance Sheet)	**1,110**	**810**

You are required to compute the following values of (i), (ii), (iii) and ratios as stipulated in PART-D, PARA-4 to the Annexure of Cost Audit Report under the Companies (Cost Records and Audit) Rules, 2014 for the year ended March 31, 2016 and 2017 respectively.

(i) Capital Employed
(ii) Net Worth
(iii) Net Revenue from Operations
(iv) PBT to Capital Employed
(v) PBT to Net Worth
(vi) PBT to Net Revenue from Operations
(vii) Debt-Equity Ratio **[2+2+2+1+1+1+1]**

7 (b) H is an employee of M/s. P Co. and gets following emoluments and benefits

(i)	**Salary**	**₹ 2,500 per month**
(ii)	**Dearness allowance** **On first ₹ 1,000 of salary** **On next ₹ 1,000 of salary** **On balance of every ₹ 1,000**	 **₹ 4,000** **₹ 1,000** **₹ 500 or @ 50% of part thereof**
(iii)	**Employers Contribution to Provident Fund**	**8% of Salary and D.A.**
(iv)	**Employer's Contribution to ESI**	**4% of Salary and D.A.**
(v)	**Bonus**	**20% of Salary and D.A.**
(vi)	**Other allowance**	**₹ 2,725 per annum**

Harish works for 2400 hours per annum, out of which 400 hours are non-productive but treated as normal idle time. A worker works for 18 effective hours in job No. 11, where the cost of direct labour is @ effective hourly cost of Harish and direct material equal to direct labour cost, overhead applied is 100%, of Prime Cost.
The sale value of the job is quoted to earn a profit of 15%.
You are requested to find out:
(A) Effectively Hourly cost of Harish, and
(B) The effective sale value of job No. 11. **[6 marks]**

Answer: 7

7 (a) **KBC LTD.**

(Amount in ₹ Lakh)

i) CAPITAL EMPLOYED: Year ended March 31	2017	2016	2017	2016	2015
Total Assets			16,700	11,852	11,160
Less: Investment in Subsidiaries			800	400	400
Less: Current liabilities			3,460	1,852	2,220
Less: Capital work in progress			1,704	-	-
			10,736	9,600	8,540
Average capital employed for the year ended March 31 (10,736 + 9,600)/2, (9,600 + 8,540)/2			**10,168**	**9,070**	
ii) NET WORTH: Share capital	3,000	2,000			
Reserves and surplus	4,360	3,250	7,360	5,250	
iii) NET REVENUE from Operations: Revenue (including excise duty) from operations	29,040	24,510	22,350	17,658	
Less: Excise Duty	6,690	6,852			
Profit before Tax (PBT)			1,310	1,270	
Working note:					
Current Liabilities:					
Current liabilities	2,660	1,252			
Short term provisions	800	600	3,460	1,852	
Debt:					
Term loans	3,080	1,650			
Debentures	1,600	1,600			
Other long term loans	1,200	1,500	5,880	4,750	
			2015	2014	
iv) PBT to Capital Employed	1310/10168	1270/9070	12.88%	14%	
v) PBT to net worth	1310/7360	1270/5250	17.80%	24.19%	
vi) PBT to net revenue from Operations	1310/22350	1270/17658	5.86%	7.19%	
vii) Debt equity ratio	5880/7360	4750/5250	0.8:1	0.9:1	

7 (b) H's earnings:

1	Salary		₹2500 per month
2	D.A.		
	On first ₹ 1000	₹4000	
	On next ₹1000 of salary	₹1000	
	On balance ₹500 of Salary	₹250	₹5250 per month
3	Total Salary and D.A.		₹7750 Per month
4	Annual salary and D.A.		₹93000 per annum
5	Employer's contribution to PF(8% Of 4)		7440
6	Employer's contribution to PF(4% Of 4)		3720
7	Bonus (20% of 4)		18600
8	Other allowance		2725

9	Total annual earnings		125485
10	Annual working hours		2400
11	Less normal idle time		400
12	Effective annual working hours		2000
13	Effective hourly cost of Harish	₹ 125485/2000 hr = ₹62.74 per hour	

(B) Statement showing effective sales value of job no. 11.

Direct labour cost (₹62.74 ×18 hrs)	1129.32
Direct material cost	1129.32
Prime Cost	2258.64
Overhead (100% of prime cost	2258.64
Total cost	4517.28
Profit (1/9 of cost)	501.92
Sale value	5019.20

8. Answer any 4 questions **[marks 4*4]**

(a) What disclosures are required to be made in Cost Statement as per CAS-19 as regard to Joint COSTS?

(b) Explain in one sentence the following with respect to Government Expenditure Audit:
- **Audit against Rules and Orders**
- **Audit of Sanctions**
- **Audit against provision of Funds.**

(c) A Management Audit team should be multidimensional. Discuss.

(d) The operating performance of the three division of ABC Ltd. for year ending 31st March 2017 is as follows:

Particulars	Division A (₹)	Division B (₹)	Division C (₹)
Sales	**3800000**	**17000000**	**20000000**
Operating Profit	**200000**	**500000**	**1000000**
Investment	**2000000**	**6250000**	**8000000**

(i) Using operating profit margin percentage as criterion, which is most profitable division?

(ii) Using rate of return on investment as the criterion, which is most profitable division?

(iii) Which of the two measures do you think gives better indication of overall performance?

(e) The president of the L N T Company has just returned from a management seminar in which the benefits of economic value added have been trumpeted. He wants to know what the calculation would be for LNT, and asks his financial analyst to find out.

The financial analyst knows that the company's cost of capital is 12.5%, having recently calculated it from the company's mix of debt, preferred stock, and common stock. He then reconfigures information from the income statement and balance sheet into the following matrix, where some expense line items are instead treated as investments.

Account Description	Performance	Net Investment
Revenue	**$6,050,000**	
Cost of goods sold	**4,000,000**	
General & administrative	**660,000**	
Sales department	**505,000**	
Training department		**$75,000**
Research & development		**230,000**
Marketing department	**240,000**	
Net income	**$645,000**	
Fixed assets		**3,100,000**
Cost of patent protection		**82,000**
Cost of trademark protection		**145,000**
Total net investment		**$3,632,000**

The return on investment for LNT is 17.8%, using the information from the preceding matrix. The calculation is $645,000 of net income divided by $3,632,000 of net investment. Finally, he includes the return on investment, cost of capital, and net investment to calculate Economic Value Added. Find the EVA.

Answer: 8

8 (a) The following disclosures are required to be made in the cost statement as per CAS-19 as regard to Joint Costs:

(i) The cost statement shall disclose the basis of allocation of Joint costs to individual products and the value assigned to the by-products.
(ii) The disclosure should be made only where material, significant and quantifiable.
(iii) Disclosures shall be made in the body of cost statements or as a foot note or as a separate schedule.
(iv) Any change in the cost accounting principles and methods applied for the measurement and assignment of the Joint costs and the value assigned to by-product during the period covered by the cost statement which has a material effect on the joint/by-products shall be disclosed. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.

8 (b) (i) Audit against Rules & orders: the auditor has to see that the expenditure incurred conforms to the relevant provisions of the statutory enactment and is in accordance with the financial rules and regulations framed by the competent authority.
(ii) Audit of sanctions: the auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, accorded by the competent authority, authorising such expenditure.
(iii) Audit against Provision of Funds: It contemplates that there is a provision of funds out of which expenditure can be incurred and the amount of such expenditure does not exceed the appropriations made.

8 (c) Management Audit is a service function with the object of assisting management in achieving the most efficient administration. Management audit involves multidisciplinary and multidimensional approach and requires systematic and

dispassionate review of analysis and appraisal of overall performance. It takes into account the techno- economic study of the Industry. As a management auditor is concerned with all aspects of business and the organization, ranging from manufacture to marketing and finance , the management audit team should be multidisciplinary to make multidimensional approach to audit function.

8 (d) The ROI, Profit margin percentage and asset turnover ratio of three divisions are as follows:

	ROI	Profit Margin percentage
Division A	₹200000/2000000 =10%	₹200000/₹3800000 = 5.26%
Division B	₹500000/₹6250000 = 8%	₹500000/₹17000000 = 2.94%
Division C	₹1000000/₹8000000 =12.5	₹1000000/₹20000000 =5%

(i) Using profit margin percentage rankings are Division A, Division C and Division B

(ii) Using ROI, rankings are Division C, Division A, Division B.

(iii) The ROI is a better measure of overall performance because it relates profits to the investments or capital.

(e) ($3,632,000 Net investment) × (17.8% Actual return – 12.5% Cost of capital)

= $3,632,000 Net investment × 5.3%

= $192,496 Economic value added

Thus, the company is generating a healthy economic value on the funds invested in it.