

FINAL EXAMINATION

GROUP- IV (SYLLABUS 2008)

SUGGESTED ANSWERS TO QUESTION DECEMBER 2013

Paper – 17: COST AUDIT & OPERATIONAL AUDIT

Time Allowed: 3 Hours

Full Marks: 100

The figures in the margin on the right side indicate full marks.

Please: (1) Answer all bits of a question at one place.

(2) Open a new page for answer to a new question.

(3) Attempt the required number of questions only.

SECTION I (50 Marks)

(Cost Audit)

Answer Question No. 1 (carrying 14 marks) which is compulsory and answer any two (carrying 18 marks each) from the rest in this Section.

1.

(a) In each of the cases/statements given below, one out of Four alternatives is correct.

Indicate the correct answer (only indicate A or B or C or D as you think correct) 1x8=8

(i) PARA — 2 of the annexure to Cost Audit Report under the Companies (Cost Audit Report) Rules 2011 deals with

- A. Cost accounting policy
- B. Product group details
- C. Related Party transactions
- D. Quantitative information of each product group separately.

(ii) Form — 1 XBRL is used for filing :

- A. Cost Audit Report of a Company
- B. Annual Report of a Company
- C. Annual Accounts of a Company
- D. None of the above.

(iii) Excisable clearance means:

- A. Only sale of goods from factory
- B. Removal from godown
- C. Despatches from bonded warehouse
- D. Total clearance from factory.

(iv) CAS—14 deals with

- A. Cost of Utilities
- B. Pollution Control Cost
- C. Employee Cost
- D. Packing Material Cost.

(v) Cost Accounting Record Rules were first made for

- A. Jute Industry
- B. Cement Industry

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C. Chemical Industry

D. Sugar Industry.

(vi) The Compliance Report is to be issued by the Certifying Cost Accountant in:

A. Form - A of the Companies (Cost Accounting Records) Rules — 2011

B. Form- B of the Companies (Cost Accounting Records) Rules — 2011

C. Form - C of the Companies (Cost Accounting Records) Rules — 2011

D. None of the above.

(vii) Soda Ash is Covered by

A. Cost Accounting Records (Chemical Industries) Rules — 2004

B. Cost Accounting Records (Formulations) Rules — 1988

C. Cost Accounting Records (Bulk Drugs) Rules — 1974

D. Cost Accounting Records (Industrial Alcohol) Rules — 1997.

(viii) According to.....on Cost of utilities, the Cost of maintaining stand-by utilities shall be the Committed Cost. (Fill in the Gap from the below)

A. CAS —5

B. CAS —6

C. CAS —8

D. CAS —10.

(b) State whether the following statements based on the quoted terms are TRUE or FALSE with justifications for your answer. No credit will be given for any answer without justifications:

1x6=6

(i) The responsibility of creating XBRL document lie with the Cost Auditor

(ii) As per CAS — 5 Warranty Costs and after sales service cost are part of selling overheads

(iii) Abridged Cost Statement (for each product group separately) is being dealt in PARA-6 of the annexure to Cost Audit Report under the Companies (Cost Audit Report) Rules — 2011.

(iv) In view of e-filing of Cost Audit Report, only one hard copy is required to be submitted to the Cost Audit Branch.

(v) CAS — 6 deals with determination of Cost of Production for Captive Consumption.

(vi) Acetate yarn/fibre is covered by the Cost Accounting Records (Textiles) Rules 1977.

Answer:

(a)

(i) → A

(ii) → A

(iii) → D

(iv) → B

(v) → B

(vi) → B

(vii) → A

(viii) → C.

(b)

(i)	FALSE:	The responsibility of creating XBRL document lies with the Company.
(ii)	FALSE:	As per CAS-15 Warranty Costs and after Sales Service Cost are part of Selling overhead.
(iii)	FALSE:	Abridged Cost Statement (for each product group Separately) is being dealt in PARA-5 of the annexure to Cost Audit Report under the Companies (Cost Audit Report) Rules - 2011.
(iv)	FALSE:	In view of e-filing of Cost Audit Report no hard Copy is required to be Submitted to the Cost Audit Branch.
(v)	FALSE:	CAS - 6 deals with principles and Methods of determining the Material Cost.
(vi)	FALSE:	Acelate yarn / Fibre is covered by the Cost Accounting Records (Rayon) Rules 1976

2.

(a) How would you treat the following as per CAS — 7 related to Employee Cost ?

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- (i) Recruitment Costs
(ii) Overtime premium
(iii) Separation Cost due to Voluntary Retirement, retrenchment, termination etc.
(iv) Bonus 1+1+2+2=6

(b) The following figures are extracted from the Cost Accounting records of ADRIJA LTD., a single product manufacturing company:

Year ended 31 st March	2013	2012
(Amount in ₹ lakhs)		
Gross Sales including Excise duty:	2,600	2,080
Excise duty	200	160
Other Income	150	100
Increase in Value of stock of Finished Goods	10	5
Raw materials Consumed	880	720
Direct wages, Salaries, Bonus, Gratuity etc.	220	176
Power & Fuel	120	96
Stores and Spares	80	70
Cess and local Taxes	60	50
Other manufacturing Overheads	215	185
Administrative Overheads:		
Audit fees	18	15
Salaries & Commission to Directors	24	20
Other Overheads	130	110
Selling and Distribution Overheads:		
Salaries & Wages	18	15
Packing and forwarding	10	8
Other overheads	125	100
Total Depreciation	60	60
Interest Charges:		
On Working Capital Loans from Bank	30	25
On Fixed Loans from IDBI	45	35
On Debentures	15	15
Provision for Taxes	158	100
Proposed Dividends	210	115

You are required to Calculate the following Parameters as Stipulated in PARA — 8 of the Annexure to Cost Audit Report under the Companies (Cost Audit Report) Rules 2011 for the year ended March 31, 2013 and 2012:

- (i) Value Addition
(ii) Earnings available for Distribution
(iii) Distribution of Earnings to the different claimants. 5+1+6=12

Answer:

(a)

- (i) As per CAS - 7, Recruitment Cost, training Cost and other such Costs shall be treated as overheads and dealt with Accordingly.
- (ii) According to CAS - 7, Overtime premium shall be assigned directly to the Cost object or treated as overheads depending on the economic feasibility and the specific circumstances requiring such overtime.
- (iii) The Separation Costs related to voluntary retirement, retrenchment, termination etc shall be amortized over the period benefitting from such Costs. The amortized Separation Costs for the period shall be treated as Indirect Cost and assigned to Cost objects in an appropriate manner. However, unamortized amount related to discontinued operations shall not be treated as Employee Cost.
- (iv) According to CAS - 7, Bonus whether payable as a Statutory Minimum or on a sharing

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of Surplus shall be treated as part of Employee Cost. Ex-gratia payable in lieu of or in addition to Bonus shall also be treated as part of the Employee Cost.

The bonus paid to employees shall be identified with each cost centre / department. For determining labour hour rate, bonus shall be estimated on the basis of past results and future forecast.

(b)

ADRIJA LTD.

CALCULATION OF VALUE ADDITION:		
	(Amount in ₹ Lakhs)	
YEAR ENDED MARCH' 31,	2013	2012
Gross Sales including Excise duty	2600	2080
Less : Excise duty etc.	200	160
Net Sales	2400	1920
Add : Export incentives	-	-
Add/ (Less) : Adjustment in Finished Stocks	10	5
	2410	1925
Less : Cost of bought out Inputs:		
(a) Cost of Materials Consumed	880	720
(b) Consumption of Stores & Spares	80	70
(c) Power & Fuel	120	96
(d) Others - Overheads	528	443
(215 + 18 + 130 + 10 + 125 + 30)=528		
(185 + 15 + 110 + 8 + 100 + 25)=443		
Total Cost of bought out Inputs	1608	1329
(i) VALUE ADDITION	802	596
Add : Other Income	150	100
(ii) EARNINGS AVAILABLE FOR DISTRIBUTION :	952	696
(iii) DISTRIBUTION OF EARNINGS TO :		
(1) Employees as Salaries, Wages, Bonus & Gratuity etc.	238	191
(2) Directors - Salaries & Commission	24	20
(3) Shareholders as dividend	210	115
(4) Company as retained funds (including depreciation)	202	170
(5) Government as Taxes:		
Cess & Local Taxes:	60	50
Income Taxes	158	100
(6) Providers of Capital / Fund as :		
Interest on Debentures	15	15
Interest on Fixed Loans from IDBI	45	35
	60	50
TOTAL DISTRIBUTION OF EARNINGS	952	696
Working Notes :	2013	2012
Others - Overheads - SL (d) :		
(1) Other manufacturing overheads	215	185
(2) Audit Fees	18	15
(3) Other Overheads (Administrative OH)	130	110
(4) Packing & forwarding	10	8
(5) Other overheads (Selling & Distributions OH)	125	100
(6) Interest on Working Capital loans	30	25
	528	443

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3.
(a)

KOOTCHAR SUGAR MILLS LTD. a Sugar manufacturing Company located at Maharashtra has a boiler which uses its own by-product, bagasse as fuel. The steam generated is first used for generation of power and the exhaust steam is used in the process of Sugar manufacture. The following details are extracted from the Financial Accounts and Cost Accounting records of Kootchar Sugar Mills Ltd:

Sugar produced	19,60,000	Quintals
Steam generated and Consumed	9,96,000	Tonnes
Fuel (Bagasse) Consumed for production of steam	4,98,760	Tonnes
Cost of generation of stem including		
Cost of water (other than fuel cost)	₹4,60,32,000	
Steam used for generation of power	4,60,000	Tonnes
Power purchased from Electricity Board @ 5.75 per KWH	38,80,000	KWH
Power generated from Steam Turbine	3,85,72,000	KWH
Variable Conversion cost for generation of Power (excluding cost of Steam)	₹3,09,71,200	

Notes :

- (1) The Sales Value of bagasse, if sold in the open market is ₹1750 per tonne.
- (2) The exhaust steam (after generation of power) transferred to Sugar manufacturing process is valued at 85% of the cost of production of steam.

Required:

- (i) Prepare Two Separate Cost Sheets for steam and power as per the Companies (Cost Accounting Records) Rules.
- (ii) Compute the average cost of Power as per PARA — 5 of the Annexure to the Cost Audit Report under the Companies (Cost Audit Report) Rules 2011. (5+4)+3=12

(b) The Companies (Cost Accounting Records) Rules — 2011 have not prescribed any specific formats for the cost statements.

In what manner and format would the cost statements be kept under these Rules? 4

(c) What is the benefit of having cost related data in XBRL format? 2

Answer:

(a)

KOOTCHAR SUGAR MILLS LTD.

COST OF STEAM :	
Cost of Fuel - Bagasse 4,98,760 tonnes @ ₹ 1,750 per tonne	₹87,28,30,000
Conversion Cost including Cost of water	₹4,60,32,000
Total Cost	₹91,88,62,000
Steam generated (Tonnes)	9,96,000
Gross Cost of Steam per tonne (91,88,62,000 ÷ 9,96,000)	₹ 922.55
STEAM DIRECTLY USED FOR SUGAR PRODUCTION: (9,96,000 – 4,60,000)tonnes x 922.55	₹ 49,44,86,800
Value of exhaust Steam from steam turbine :	
At 85% of Cost = 4,60,000 x 922.55 x 0.85 : (A)	₹ 36,07,17,050
Total Cost of Steam used for Sugar Production:	₹85,52,03,850
Average Cost of Steam per tonne: (85,52,03,850 ÷ 9,96,000)	₹ 858.64
For disclosure in PARA - 5 of the Annexure to Cost Audit Report:	

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Steam Consumption per quintal of Sugar (9,96,000 ÷ 19,60,000)	0.5082 tonnes
Steam Cost per quintal of Sugar : (85,52,03,850 ÷ 19,60,000)	₹ 436.33
Cost of POWER	
Cost of high pressure steam sent to Steam Turbine (4,60,000 x 922.55)	₹ 42,43,73,000
Conversion Cost for generation of Power	₹ 3,09,71,200
TOTAL	₹ 45,53,44,200
Less : Credit for exhaust Steam Transferred to Sugar Manufacture in Steam Cost	₹ 36,07,17,050
NET COST OF POWER GENERATED	₹ 9,46,27,150
Power Generated	3,85,72,000 kWH
Cost of Power Generated per kWH	₹ 2.45

For disclosure in PARA - 5 of the Annexure to the Cost Audit Report:

Particulars	Quantity kWH	Cost of Power	
		₹	₹/kWH
a) Own Generation	3,85,72,000	9,46,27,150	2.45
b) Purchased @ ₹5.75	38,80,000	2,23,10,000	5.75
	4,24,52,000	11,69,37,150	2.755

Power Consumed per quintal of Sugar : (4,24,52,000 kWH ÷ 19,60,000) = 21.66 kWH	
Power Cost per quintal of Sugar : 21.66 kWH x ₹ 2.755	₹ 59.67

(b)

As per Sub rule (2) of Rule 4, the Companies are required to maintain Cost records on regular basis in such manner so as to make it possible to Calculate per unit cost of production or cost of operations, Cost of Sales and margin for each of its products and activities for every financial year on monthly / quarterly / half- yearly / Annual basis. The cost statements are to be prepared for every unit and every product produced, processed, manufactured or mined.

As per sub-rule (3), the cost records are to be maintained in accordance with the generally accepted Cost accounting principles and cost accounting standards (CASs) issued by the Institute; to the extent these are found to relevant and applicable.

(c)

Government and Regulators require Cost data of different Sectors for policy making. The availability of Cost data [without compromising on the Confidentiality] in XBRL format enables informed decision making and for Sectoral Studies. With full adoption of XBRL, Companies would be able to integrate its financial and cost data across its operational areas and exercise better control on its activities.

4.

(a) **VINTEX LTD. having turnover above ₹100 Crore undertakes work contracts for pipe line execution for drinking, sewerage and irrigation purpose. The required pipes for the projects falling under Chapter 68 of CETA are manufactured by the Company itself. A part of the production is also sold outside.**

Whether Cost Audit is applicable for Pipe manufacture.

4

(b) **Answer the following questions with respect to the Companies (Cost Audit Report) Rules — 2011.**

2x2 =4

(i) **Who will certify XBRL filing for Cost Audit Report?**

(ii) **Is Performance Appraisal Report required to be filed with the Central Government as a**

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part of the Cost Audit Report?

(c) The following figures are extracted from the Financial Accounts of SIMON LTD. for the year ended March 31, 2013.

Particulars	(₹)	(₹)
Sales (20,000 units)		50,00,000
Materials		20,00,000
Wages		10,00,000
Factory Overheads		9,00,000
Administrative Overheads		5,20,000
Selling and Distribution Overheads		3,60,000
Finished Goods (1230 units) (closing)		3,00,000
Work – in – Progress :		
Materials	60,000	
Labour	40,000	
Factory overheads	40,000	1,40,000
Goodwill written off		4,00,000
Interest paid on Capital		40,000

In the Costing records, Factory overheads is charged at 100% of Wages, Administrative overheads 10% of Factory Cost and Selling and Distribution overheads at the rate of ₹20 per unit sold.

Required:

Prepare a Statement Reconciling the Profit as per Cost Records with the Profit as per Financial Records. (3+3)+4=10

Answer:

(a)

Applicability of Cost Audit is based on turnover of the Total Company. Any activity of a Company, irrespective of the turnover of the particular activity, would be covered under cost audit if that particular activity is one of the activities listed in the cost audit Order No. 52/26/CAB - 2010 dated 2nd May 2011 or 30th June 2011.

Whether the Company under reference will attract cost audit for its pipe manufacturing activity will now depend on whether the Captive Consumption is made for a product which is under- cost audit. In this case it is not so and the pipe manufacturing will attract cost audit under this test.

However, if the production of pipes is an ancillary activity as defined in MCA General Circular No. 67/2011 dated 30th November 2011, then pipe manufacturing would be outside preview of cost audit.

(b)

(i) The Cost Auditor [or the lead Cost Auditor in case the Company has more than one Cost Auditor] is required to digitally sign and file the Cost Audit Report for the Company as a whole.

(ii) As per Provisions of the Companies (Cost Audit Report Rules - 2011, every Cost Auditor who submits a Cost Audit Report, is also required to furnish Performance Appraisal Report to the Board / Audit Committee of the Companies in the prescribed format (Form - III). However, this report will not be required to be filed with the Central Government.

(c)

SIMON LTD.

Profit & Loss account for the year ended March 31, 2013

Particulars	₹	Particulars	₹
To opening Stock	NIL	By Sales (20000 Units)	50,00,000

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To Materials	20,00,000		
To Wages	10,00,000	By Closing Stock (1230 units)	3,00,000
To Factory Overheads	9,00,000		
To Administrative Overheads	5,20,000	By Work-in-Progress	1,40,000
To Selling & Distribution Overheads	3,60,000		
To Good will Written off	4,00,000		
To Interest on Capital	40,000		
To Balance c/d (Net Profit)	2,20,000		
	54,40,000		54,40,000

Profit & Loss statement of cost Accounts for the year ended March 31, 2013

Particulars	₹
Materials	20,00,000
Wages	10,00,000
Prime Cost	30,00,000
Add : Factory overheads @100% of wages	10,00,000
	40,00,000
Less : Work-in-Progress	1,40,000
Factory Cost (20000 + 1230) Units	38,60,000
Administrative overheads @ 10% of Factory Cost	3,86,000
	42,46,000
Less : Closing stock of finished Goods (1230 units) [w. note]	2,46,000
Cost of Production	40,00,000
Selling & Distribution overheads ₹ @ 20 per unit sold	4,00,000
Cost of Sales (20,000 units)	44,00,000
Sales Revenue (20,000 units)	50,00,000
PROFIT	6,00,000

Working Note:

Cost of 21,230 units is	₹42,46,000
Therefore cost of one unit is	₹200
Hence cost of 1,230	₹2,46,000

RECONCILIATION STATEMENTS

Particulars	₹	₹
Profit as per Cost Records		6,00,000
Add : Factory overheads over-absorbed (₹ 10,00,000 - ₹ 9,00,000)	1,00,000	
Selling & Distribution overheads - over absorbed (₹4,00,000 - ₹ 3,60,000)	40,000	
Difference in the valuation of closing stock of finished goods (₹ 3,00,000 - ₹ 2,46,000)	54,000	1,94,000
		7,94,000
Less : Administrative overheads under absorbed (₹5,20,000 - ₹3,86,000)	1,34,000	
Goodwill written off relates to Financial Accounts	4,00,000	
Interest on Capital	4,000	5,74,000
PROFIT as per Financial Accounts		2,20,000

SECTION II (50 Marks) (Operational Audit)

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Answer Question No. 5 (carrying 14 marks) which is compulsory and answer any two (carrying 18 marks each) from the rest in this Section.

5.

(a) State whether the following statements based on the quoted terms are "TRUE" or "FALSE" with justifications for your answer. No credit will be given for any answer without justifications.

1x6=6

- i) Corporate image of a Company is built up exclusively by its product quality but is not affected by its attitude towards its other stakeholders.
- ii) Operational Audit is merely extension of internal Auditing in operational areas.
- iii) Dumping is an 'illegal' practice.
- iv) For stock hypothecation to the Bank, Insurance Coverage is required for seventy five percent of stock as margin money.
- v) Three-fourths of the members of the Audit Committee shall be independent directors.
- vi) The Consumer Service Audit critically examines the outstanding payment of Consumers.

(b) Fill in the blanks in the following sentences by using appropriate word (s) / Phrase (s)/ number (s):

1x 8= 8

- i) Corporate objectives represent the.....for the organization as laid down by itself.
- ii)is transfer of goods to an alien market at a price which is less than the marginal cost of its production in the home country.
- iii) The main emphasis of Management Audit is problem.....rather than problem solving.
- iv) is the highest body of the structure of the WTO.
- v) is needed to create corporate culture of transparency.
- vi) The origin of the term "Due Diligence" owes to.....
- vii)Pollution affects pedestrians and motorists due to the presence of dust, fumes and smoke in the atmosphere.
- viii) The Audit Committee shall meet at least.....a year as per the SEBI listing agreement.

Answer:

(a)

- i) **FALSE:** Corporate image is not confined to its product quality only, but it extends to all its field of business.
- ii) **TRUE:** Objective of operational Audit is to assist the organization to perform its functions more effectively and economically with focus on effectiveness of operations.
- iii) **FALSE:** Dumping is an 'unfair' practice.
- iv) **FALSE:** For stock hypothecation to the Bank Insurance coverage is required for FULL VALUE.
- v) **FALSE:** Two-Thirds (2/3rd) of the members of the Audit Committee shall be independent directors.
- vi) **FALSE:** The consumer service Audit critically examines and appraises management of responsibility of a business enterprise towards consumers, to make available the products of the right qualities at right time, in right quantity, at right place and right price.

(b)

- i) Charter
- ii) Dumping
- iii) Identification
- iv) The Ministerial Conference
- v) Corporate Governance
- vi) US Securities Act 1933

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- vii) Visual
- viii) Four times

6.

(a) ARITHI LTD. engaged in manufacturing of chemicals is consistently recording higher sales turnover, but declining net profits since the last 5 years.

As a Management Auditor appointed to find out the reasons for the same, what are the points you would investigate ? 8

(b) Enumerate the main areas to be covered by the Auditor in the case of Environment Audit of an Industrial Unit. 6

(c) State briefly the salient features of the traditional form of Internal Audit and Operational Audit. 4

Answer:

(a) As per the facts that there has been consistently high turnover but declining net profits is an anomalous situation. It may be attributed to one or more following reasons requiring further investigation:

(i) Unfavorable Sales mix: Where the company sells different chemical products with different product margins, the product with the maximum PV ratio/margin should have a higher share in the total sales. If due to revision of sales mix, more quantities of unprofitable products are sold, profits will be reduced inspite of an increase in sales.

(ii) Negative impact of Financial Leverage: Where the company does not have sufficient own funds (equity) but has a higher debt-equity ratio, the interest commitments will be higher. As the volume of its operation increases, higher debt and interest charges would result in lower profits.

(iii) Other items included in Sales: The figure of sales as per Profit and Loss Account may include incidental revenues, e.g., freight, excise duty, sales tax, etc, where the amount of excise duty goes up considerably the total sales may show an increase which is not represented by a real increase in sales quantity/value.

(iv) High Administrative and Selling Expenses: Administrative and selling costs are generally period costs which are fixed in nature. Their increase is generally not proportional to sale increase. However, a reduction in profit could also be due to increase in administrative overheads and sales overheads at a rate higher than the rate of increase in sales.

(v) Cost-Price Relationship: If the increases in cost of raw materials and labour has not been compensated by a corresponding increase in the sales price this would also result in higher sales and declining profits. In spite of same sales quantity, for the increasing cost of raw materials and other services, per unit values of the product has been increased which is however unmatched by the increase in cost.

(vi) Competitive Price : Where sales have been made at cut-throat prices in order to eliminate competition from the market, the profits would be in the declining trend in the short-run.

(vii) Additions to Fixed Assets: Where there are heavy additions to fixed assets and consequent depreciation charges in the initial years of additions, there may be reduction in profits in spite of increased sales.

(b) Main areas to be covered in the case of environment audit of industrial unit are enumerated below:

❖ Layout and design of the factory to provide for the installation pollution control

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- devices with provision for up gradation of pollution control measures to meet regulatory authorities' requirements. Areas of deficiency to be included in the report.
- ❖ The use of all resources such as air, water, land, energy, raw material and human resources with minimum waste and interlinking for best results to be looked into and reported.
 - ❖ It has to be reported whether all pollution control measures in vogue are effective with reference to the type of industry, nature of working and grade of polluting the environment.
 - ❖ Availability of adequate trained staff and safety amenities with provision for constant up gradation to be verified.
 - ❖ Availability of adequate health care provisions and medical facilities for the workers to be looked into.
 - ❖ Availability of proper system to eliminate industrial unhygienic state.
 - ❖ Availability of adequate safeguard against occupational health hazards depending upon the nature of industry to be verified.
 - ❖ Existence of adequate information system and reporting of compliance of statutory legal provisions to the board at regular intervals to be verified.
 - ❖ Compliance of regularly mechanism by way of updating the existing environment system with the latest changes in the regulations to be looked into.
 - ❖ It has to be verified as to how social aspects are addressed by the Industry as they have an obligation to protect the Society from pollution hazards of the Industry.

(c) The following table highlights salient features of the traditional form of Internal Audit and Operational Audit.

Internal Audit	Operational Audit
1. Compliance Objective	Risk identification, process improvement objective.
2. Financial Accounts Focus	Business Focus
3. Audit Focus.	Efficiency and improvement Focus
4. Transaction Based	Process Based
5. Policies and procedures Focus	Risk Management Focus
6. Cost Centre wise budget Monitoring	Accountability for performance Improvement results.
7. Focus on policies, transactions and Compliance	Focus on goals, strategies and risk management process.

7.

- (a) **The Chief Commissioner of Customs has appointed you to carry out a Special Audit of Accounts of ANUKRITA LTD. which manufactures goods in Customs Bonded Warehouse. What are the points you will cover in your report ?** 6
- (b) **Explain the Constitution and functions of AUDIT Committee under Section 292A of the Companies Act 1956.** 2+4=6
- (c) **Explain whether the following activities amount to professional misconduct on the part of a Cost Accountant.**
- i) **CMA K. Kumar a practicing Cost Accountant certified the cost statements of SARATHI LTD. in which his wife is a Director holding substantial interest.**
 - ii) **CMA ARTHITA BASU a practicing Cost Accountant had accepted appointment as an Cost Auditor of VENTEX LTD. without ascertaining from the Company whether the requirement of Section 224 and 225 of the Companies Act had been complied with. She realized this defect only after acceptance.**
 - iii) **CMA AINDRIL a practicing Cost Account has sent letters under Certificate of Posting to**

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the previous auditor informing him his appointment as an Cost Auditor before the commencement of Audit by him. 2x3=6

Answer:

(a) To procedure for Special Audit of Accounts for goods manufactured in Bonded Warehouse has been laid down in the Board's regulations issued in 1966. The procedures have not been considerably simplified since then but physical control and supervision of customs officer on the bonded warehouse has been done away with since July 1998.

The basic records to be maintained are as follows:

- a. Bond register showing receipts and issues of goods.
- b. Issue Notes
- c. Manufacturing Register
- d. Finished product Register
- e. Reject/Scrap Register
- f. Export register
- g. Subcontract Register
- h. DTA sale Register
- i. Indigenous Goods register

The audit report should cover the following:

- i) Basic information about the manufacturer like management controlling unit, capital structure, major raw materials, location of registered office and factories etc.
- ii) Details of manufacturing process and major capital equipment.
- iii) Input output rations – norms Vis –a – Vis actual.
- iv) Documents checked
- v) Correlation of customs documents of import of Inputs and Export of Final products with financial accounts.
- vi) The details of scrap sales.
- vii) Sales in Domestic Tariff Area (DTA)
- viii) Any other specific observation which is relevant for the audit.

However no comment should be made on admissibility or otherwise of any Cenvat Credit, as it is the function of the adjudicating authority alone.

(b) Section 292A of the Companies Act, 1956 requires that every public company having not less than ₹5 crores of paid up capital shall constitute a committee of Board known as Audit Committee. It shall consist of not less than three directors and such number of other Directors as the Board may determine of which two-third shall be directors other than the Managing Director and whole time director. They shall elect one such member amongst them as Chairman. The auditors, the internal auditor, if any, and the director-in-charge of finance shall attend and participate at meetings of the Audit Committee but shall not have the right to vote.

Every audit committee constituted as above shall act in accordance with the terms of reference specified in writing by a Board. The function of the audit committee as specified in the Companies Act, 1956 are as under:

- i) The audit committee should have discussions with the auditors periodically about the Internal control systems, the scope of audit, the audit observations and review the periodical financial statements before submission to the board and also ensure compliance with the internal control systems:
- ii) It shall have the authority to investigate any matter in relation to the items specified in this section or reference to it by the Board and shall have access to the information contained in the records of the company and external professional advice, if

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necessary.

- iii) Its recommendations on all financial matters including audit report shall be binding on the board.
- iv) To advise and check the compliance of the organization for policy and regulation aspects.

(c)

- (i) Clause 4 of Part -1 of second schedule to the cost and works Accountants Act 1959 states that if an auditor expresses his opinion on the cost or pricing statements of any business or enterprise in which he, his firm or partner in his firm has substantial interest, he is committing professional misconduct unless he discloses the interest also in his report.

Substantial interest in relation to an individual, means the beneficial interest held by such individual or any of his relatives.

In the given case CMA. K. Kumar has certified the cost statements of **Sarathi Ltd.** in which his wife is a director with substantial interest. Hence this amounts to professional misconduct According clause (4) of Part-1 of the second schedule to the cost and works Accountants Act 1959.

- (ii) The auditor to ascertain from the company whether the relevant requirements have been complied with or not. However, in the instant case, Arthita Basu, before acceptance of his appointment as an auditor has failed to ascertain whether the provisions of Sections 224 and 225 have been complied with by the company. The fact that Arhita has realized this defect only after acceptance would not save him from charge of misconduct. It is necessary for the incoming auditor to verify the relevant records of VENTEX LTD to enable him to ascertain whether the provisions of sections 224 and 225 have been complied with. Therefore, ARTHITA BASU its guilty of professional misconduct under Clause (9) of Part 1 of First Schedule to the Cost and works Accountants Act 1959.

- (iii) Clause 8 of Part 1 of the First Schedule to the Cost and works Accountants Act, 1959 requires communication in writing by the incoming auditor with the previous auditor before accepting a position by him. The Council of the institute has taken the view that a mere posting of a letter "under certificate of posting" is not sufficient to establish communication with the retiring auditor unless there is some evidence to show that the letter has in fact reached the person communicated with. A Cost Accountant who relies solely upon a letter posted "under certificate of posting" therefore does so at his own risk. Since the letters were sent by AINDRIL to the previous auditor informing him of his appointment as an auditor before the commencement of audit by him under Certificate of Posting is not sufficient to prove communication with the retiring auditor. In the opinion of the Council, communication by a letter sent "Registered Acknowledgement Due" or by hand against a written acknowledgement would in the normal course provide positive evidence. Hence AINDRIL is guilty of professional misconduct under Clause (8) of Part 1 of First Schedule to the Cost and works Accountants Act, 1959.

8. Write short notes on any three out of the following:

6x3=18

- (a) Ministerial Conference;**
- (b) Professional Behaviour in Relation to an Accountant;**
- (c) Assurance Services;**
- (d) Due Diligence Audit.**

Answer :

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(a) MINISTERIAL CONFERENCE :

The Ministerial Conference (MC) is the highest body of World Trade Organisation. It is composed of all Members. The MC is responsible for carrying out all functions of the WTO. It has authority to take decisions in any matters under relevant Multilateral Trade Agreement. (MTA). The MC shall meet in every two years.

The MC has three functional committees for discharge of its functions assigned Under MTA :

- (a) Committee on Trade and Development.
- (b) Committee on Balance – of – payments restrictions.
- (c) Committee on Budget, Finance, and Administration

The committee may establish additional committees with specific functions assigned to them.

(b) PROFESSIONAL BEHAVIOUR IN RELATION TO AN ACCOUNTANT:

The principle of professional behavior imposes an obligation on professional accountants to comply with relevant laws and regulations and avoid any action that may bring discredit to the profession. This includes actions which are reasonable and informed third party, having knowledge of all relevant information, would conclude negatively affects the good reputation of the profession.

In marketing and promoting themselves and their work, professional accountants should not bring the profession into disrepute. Professional accountants should be honest and truthful and should not:

- (i) Make exaggerated claims for the services they are able to offer, the qualifications they possess, or experience they have gained; or
- (ii) Make disparaging references or unsubstantiated comparisons to the work of others.

The conceptual framework requires a professional accountant to identify, evaluate and address threats to comply with the fundamental principles, rather than merely complying with a set of specific rules, which may be arbitrary. If threats to ethics are not clearly insignificant, a professional accountant should apply safeguards to eliminate the threats or reduce them to an acceptable level.

(c) ASSURANCE SERVICES:

It is defined as "independent professional services that improve the quality of information, or its context, for decision makers".

Advances in information technology have dramatically increased companies' reliance on computerized information systems to conduct operations and to gather and report performance information both internally and externally. Maintaining operations and reliably reporting performance information requires 'assurance'. So, cost and management accounting profession in India is committed to provide services of high quality in the public interest as per international standard. So, the standards are being developed and promulgated one Standard Board as per International Auditing and Assurance Standard Board called as Cost Audit & Assurance Board (CAAB). Assurance services focus primarily on improving the information rather than on providing advice or installing system. It includes all types of information.

All types of information's Assurance Services include:

- (1) Assessment of ethics-related risk and vulnerability
- (2) Controls over and risk related investment
- (3) Adequacy of controls and policies for derivatives
- (4) Fairness of Inventory Valuation
- (5) Valuation of intangible assets
- (6) Optimum product mix and maximization of profit
- (7) Information systems security reviews

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- (8) Fraud and illegal act risk assessment
- (9) Scope of Cost Reduction -
- (10) After Sales Service for Customer satisfaction
- (11) Identification of key factors to monitor and ISO- 9000 certification
- (12) Assurance that systems are designed and operate in a manner that provides reliability of information and so on.

(d) DUE DILIGENCE AUDIT :

Due Diligence means care and precaution. In the context of a Merger and Acquisition transaction, it means background checking or the intense examination of a target asset for acquisition by a prospective buyer. Due Diligence Audit is A fact-finding audit to assist in taking the financial decision - whether to buy the target asset or how much price to pay for the acquisition or how to structure the financial transaction. The main objective is to verify the assertions made by the seller and to identify caveats which may (5) not have been disclosed by the seller. A comprehensive due diligence audit will cover the following fields, as suggested by Luis F. Gillman:-

- (i) Compatibility Audit
 - (ii) Financial Audit
 - (iii) Macro-environmental Audit
 - (iv) Legal-environmental Audit
 - (v) Marketing Audit
 - (vi) Production Audit
 - (vii) Management Audit
 - (viii) Information System Audit
 - (ix) Reconciliation Audit
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