

FINAL EXAMINATION

GROUP IV

(SYLLABUS 2008)

SUGGESTED ANSWERS TO QUESTIONS

JUNE 2012

Paper- 17 : COST AUDIT AND 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 question only.*

Answer Question No. 1 and Question No. 5, which is compulsory and any two each from the remaining questions of Section I and Section II.

SECTION - I (50 Marks)

(Cost Audit)

- Q. 1. (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 :
- (i) A Cost Accountant, who is appointed as the Concurrent Auditor of a Company, can accept appointment as Cost Auditor of the same Company.
 - (ii) M/s. JTS Company situated in Jamshedpur has been planning to file a single form 23C by appointing BMS & Associates a Cost Audit firm for all the three different types of products covered under Cost Audit.
 - (iii) It is imperative that a Resolution has to be passed by the Board of Directors for the appointment of the Cost Auditor.
 - (iv) The Cost Accounting Record Rules are applicable to all Companies including to other form of business.
 - (v) In view of e-filing of Cost Audit Report, only one hard copy is required to be submitted to the Cost Audit Branch. [1×5]

2 ♦ Suggested Answers to Question — COA

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

- (i) The _____ will be the Secretary of the Cost Accounting Standard Board (CASB).
- (ii) There _____ violation of section 215 of the Companies Act 1956 where the audit of Accounts is completed before approval of the Balance Sheet by the Board of Directors.
- (iii) The Cost Accounting Record Rules were first made for the _____ Industry.
- (iv) Outward transportation Cost as per CAS-5 shall form part of Cost of _____ .
- (v) Rectified spirit is covered by the Cost Accounting Record (_____) Rules 1997.

[1×5=5]

(c) In each of the cases/statements given below, one out of four alternatives is correct. Indicate the correct (only indicate A or B or C or D as you think correct) :

- (i) Abnormal non-recurring Costs are being dealt with Annexure to the Cost Audit Report Rules in
 - A. Para-15
 - B. Para-16
 - C. Para-17
 - D. Para-20
- (ii) Cost Auditor should inform to the Central Government in Form 23D of his appointment within :
 - A. 90 days from receiving formal letter from the company.
 - B. 30 days from receiving formal letter from the company.
 - C. 90 days from the date of commencing of the current financial year.
 - D. 45 days from the date of commencing of the current financial year.
- (iii) Cost Auditor is required to provide reply to any clarification sought for, by the Central Government from the Cost Auditor in writing of the receipt of the communication addressed to him calling such clarification within
 - A. 45 days of the receipt of the communication.
 - B. 30 days of the receipt of the communication.
 - C. 180 days of the receipt of the communication.
 - D. 120 days of the receipt of the communication.
- (iv) Where default is made by the Cost Auditor in complying with the provisions of Rule 4 or Rule 5 (of the Cost Audit Report Rules) he shall be punishable with fine which may extend to
 - A. ₹ 7000
 - B. ₹ 6000
 - C. ₹ 5000
 - D. None of the above.

[1×4]

Answer 1. (a)

(i) **False.**

A Cost Accountant who is appointed as the Concurrent Auditor of a company cannot accept appointment as Cost Auditor of the same Company. As a Concurrent Auditor, he is viewed as a person holding an office of profit of the company and he cannot be appointed as the Cost Auditor of the same company.

(ii) **False.**

The company would be required to file individual Form 23C for each product under Cost Audit even if M/s BMS & Associates Cost Audit firm is appointed for all the products.

(iii) **True.**

Since the appointment of the Cost Auditor is subject to the previous approval of the Central Government, the Board Resolution (Appendix-1.C) should specifically mention that 'Subject to the approval of the Central Government and pursuant to the Provisions of Section 233B of the Companies Act, 1956 Mr./Ms.....be and is hereby appointed as "Cost Auditor".'

(iv) **False.**

The Cost Accounting Record Rules are applicable only to selected Companies incorporated under the Companies Act 1956 (Whether private or public) and not to other forms of business such as partnership, proprietary etc.

(v) **False.**

In view of e-filing of Cost Audit Report no hard copy is required to be submitted to the Cost Audit Branch.

Answer 1. (b)

- (i) Director (Technical), The Institute of Cost Accountants of India.
- (ii) is no
- (iii) Cement
- (iv) Sale
- (v) Industrial Alcohol

Answer 1. (c)

- (i) C. / None of the above
- (ii) B.
- (iii) B.
- (iv) C.

Q. 2. (a) ANKRIT PHARMA LTD. uses two ingredients M and N for production of a formulation 'Z' in the ratio of 2:3.

M is procured entirely from indigenous sources, whereas 50% of N is imported. The ratio of imports and indigenous sources is maintained throughout the year. The input/output ratio of raw materials

4 ♦ Suggested Answers to Question — COA

to finished goods is 1: 0.9. During the year 2011-12, the company produced 270 tonnes of finished product of Z and the consumption of raw materials was as follows :

M — 1,21,500 kgs @ ₹ 360 per kg

N — 1,78,400 kgs at an average cost of ₹ 220 per kg

During the year, the company imported 90,000 kgs of N and the breakup of landed cost was as follows :

	(₹)
CIF Value	1,86,43,000
Import Duty	18,63,600
Clearing & Forwarding Charges	10,45,000
Landed Cost	<u>2,15,51,600</u>

Required :

How will you present the above information in the manner prescribed in Paras-5A, 5B and 6 of the Annexures to the Cost Audit Report? [7+2+2+2=13]

- (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? [5]

Answer 2. (a)

ANKRIT PHARMA LTD.

Total Production	270 tonnes	= 2,70,000 kgs
Theoretical consumption of Raw Materials in the Ratio of 1 : 0.9	$= 2,70,000/0.9$	= 3,00,000 kgs
Composed of: Raw Materials M	$= 2/5^{\text{th}}$	= 1,20,000 kgs
Raw Materials N	$= 3/5^{\text{th}}$	= 1,80,000 kgs
Actual consumption:	M	= 1,21,500 kgs
	N	= 1,78,400 kgs
Norms of consumptions	$M = 1,20,000/2,70,000$	= 0.4444
	$N = 1,80,000/2,70,000$	= 0.6667
Actual consumption rate	$M = 1,21,500/2,70,000$	= 0.45
	$N = 1,78,400/2,70,000$	= 0.6606

Imported materials :

Actual quantity of imported material N consumed (50% of 178400)	= 89,200 kgs
Total Value of N consumed = 1,78,400 kgs × ₹ 220 per kg.	= ₹ 3,92,48,000
Less: Value of imported material consumed = 89,200 kgs × ₹ 2,15,51,600/90,000	= ₹ 2,13,60,030
Value of indigenous material N consumed (89,200kgs)	= ₹ 1,78,87,970
Cost per kg of indigenous material N	= ₹ 200.53 or 200.54
Cost per kg of imported material N = 2,15,51,600/90,000	= ₹ 239.46

The above data will be presented in the Annexure to Cost Audit Report as follows :

Para 5(A)

MAJOR INPUT MATERIALS CONSUMED

Particulars	Current Year (2011-2012)			2010-11 and 2009-10		
	Qty (kg)	Rate (₹)	Amount (₹ in Lakh)	Qty (kg)	Rate (₹)	Amount (₹ in Lakh)
1. Indigenous						
(a) M	1,21,500	360.00	437.40	—	—	—
(b) N	89,200	200.54	178.88	—	—	—
2. Self manufactured	—	—	—	—	—	—
3. Imported						
(a) N	89,200	239.46	213.60			
4. Total	2,99,900		829.88			

Para 5(B)

STANDARD/ACTUAL CONSUMPTION OF INPUT MATERIALS PER UNIT:

Particulars	Unit	Standard	Actual		
			2011-12	2010-11	2009-10
1. M	Kg	0.4444	0.4500	—	—
2. N	Kg	0.6667	0.6606	—	—

Para 6

BREAK UP OF COST OF INPUT MATERIALS IMPORTED DURING THE YEAR:

Particulars	2011-12 (₹ in lakh)	2010-11 (₹ in lakh)	2009-10 (₹ in lakh)
1. CIF price	186.43	—	—
2. Custom Duty	18.64	—	—
3. Clearing and Forwarding	10.45	—	—
4. Total Landed Cost	215.52	—	—

Alternative Solution to Q. No. 2(a)

The above data will be presented in the Annexure to Cost Audit Report as follows

Annexure-4 : QUANTITATIVE INFORMATION

Name of the Company : Ankrit Pharma Ltd.			
Name of the Product Group	Product-Z		
Name of the Products covered in the Product Group	Product-Z		
Financial year		2011-12	2010-11
Particulars	Unit (kgs)	Current year	Previous year
1. Available Capacity			
(a) Installed capacity			
(b) Capacity enhanced during the year, if any			
(c) Capacity available through leasing arrangement, if			
(d) Capacity available through loan license/third parties			
(e) Total available Capacity			
2. Actual production			
(a) Self manufactured	270000	270000	—
(b) Produced under leasing arrangements			
(c) Produced on loan license/by third parties on job work			
(d) Total Production	270000	270000	—
3. Production as per Excise Records			
4. Capacity Utilisation (In house)			
5. Stock Purchased for Trading			
(a) Domestic Purchase			
(b) Imports			
(c) Total Purchases			
6. Stock & Other Adjustments	—	—	—
(a) Change in stock of finished goods			
(b) Self/Captive Consumption (incl. Samples etc)			
(c) Other quantitative Adjustment, if any (Wastage etc)			
(d) Total Adjustments	—	—	—
7. Total available quantity for sale [2 (e) + 5 (c) 6 (d)]	2,70,000	2,70,000	
8. Actual Sales			
(a) Domestic Sales (manufacturing)			
(b) Domestic Sales (Trading)			
(c) Export Sale (Manufacturing)			
(d) Total Quantity Sold			

Annexure-5 : ABRIDGED COST STATEMENT (for Product-Z)

S. No.	Particulars	Units	Qty in Kg	Rate (₹)	Amount (₹ in Lakh)	Rate per unit (Kg) (₹)	
						Current 2011-12 year	Previous 2010-11 year
1.	Materials consumed (specially details)		299900	276.72	829.88	276.72	
	(a) Indigenous purchased	M	121500	360.00	437.40	360.00	—
		N	89200	200.54	178.88	200.54	—
	(b) Imported	N	89200	239.46	213.60	239.54	—
	(c) Self Manufactured/Produced	—					
2.	Process materials/chemicals (specify)						
3.	Utilities (Specify details)						
4.	Direct employees cost						
5.	Direct Expenses						
6.	Consumable Stores & Spares						
7.	Repairs & Maintenance						
8.	Quality Control Expenses						
9.	Research & Development Expenses						
10.	Technical know-how fee/Royalty, if any						
11.	Depreciation/Amortization						
12.	Other production overheads						
13.	Total (1 to 12)						
14.	Add/Less : Work in progress Adjustments						
15.	Less : Credit for Recoveries, if any						
16.	Primary Packing cost						
17.	Cost of production/operation (12 + 13 to 17)						
18.	Increase/Decrease in Stock of finished goods						
19.	Less : Self/Captive consumption (incl. samples etc)						
20.	Other Adjustment (if any)						
21.	Cost of Production/Operation of Goods/ Services Sold (17+ 18 to 20)						
22.	Administrative Overheads						
23.	Secondary Packing Cost						
24.	Selling and Distribution Overheads						
25.	Interest & Financing Charges						
26.	Cost of Sales (21+22 to 25)						
27.	Net sales Realization (net off taxes and duties)						
28.	Margin [Profit/Loss] as per cost accounts] (27-26)						

Answer 2. (b)

As per sub rule (2) of Rule 4 of the Companies (Cost Accounting Records) Rules 2011 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), of Rule 4 of the companies (Cost Accounting Records) Rules, 2011 the cost records are to be maintained in accordance with the generally accepted cost accounting principles and cost accounting standards issued by the Institute; to the extent these are found to be relevant and applicable. The variations, if any, shall be clearly indicated.

These Rules have not prescribed any specific formats for the cost statement. A guidance note on the subject is under preparation by ICAI interalia, containing model formats for cost records, statements, schedules etc.

Q. 3. (a) How would you treat the following as per CAS-9 related to Packing Material Cost?

- (i) Primary and Secondary packing material cost.
- (ii) Self manufactured packing material.
- (iii) The forex component of imported packing material. [2×3=6]

(b) The profit as per Financial Accounts of JANARDHAN CEMENT LTD. for the year 2011-12 was ₹ 1,54,28,642.

The profit as per Cost Accounting Records for the same period was less.

The following details are collected from the Financial Accounting Schedules and Cost Accounting records :

	Financial Accounts (₹)	Cost Accounts (₹)
Valuation of Stock :		
Opening: WIP	25,62,315	22,65,710
Finished goods	2,65,47,520	2,92,18,950
Closing : WIP	42,75,640	37,36,346
Finished goods	3,72,59,430	4,35,25,149
Interest income from inter-corporate deposits	6,15,340	—
Donations given	4,85,560	—
Loss on Sale of Fixed Assets	1,22,546	—
Value of cement taken for own consumption	3,82,960	3,65,426
Cost of Power drawn from own Wind Mill		
— At EB Tariff		49,56,325
— At Cost	36,20,370	—
Non-opening income	45,36,770	—
Voluntary retirement compensation	16,76,540	—
Insurance claim relating to previous year received during the year	14,35,620	—

You are required to Prepare a Reconciliation Statement and arrive at the Profit as per Cost Records. [4+6+2=12]

Answer 3. (a)

- (i) As per CAS-9, the cost of primary materials shall form part of the cost of production. Cost of secondary packing materials shall form part of distribution overheads.
- (ii) Self manufactured packing materials shall be valued including direct material cost, direct employee cost, direct expenses, job charges, factory overheads including share of administrative overheads comprising factory management and administrative and share of research and development cost incurred for development and improvement of existing process or product.
- (iii) The forex component of imported packing material cost shall be converted at the rate on the date of the transaction. Any subsequent change in the exchange rate till payment or otherwise shall not form part of the packing material cost.

Answer 3. (b)**JANARDHAN CEMENT LTD.****RECONCILIATION OF FINANCIAL PROFIT AND COSTING PROFIT FOR THE YEAR 2011-12**

Figure in ₹

Profit as per Financial Accounts		1,54,28,642
<i>Add</i> : Difference in Stock Valuation	33,51,600	
Loss on Sale of Fixed Assets	1,22,546	
Donation not considered in Cost Accounts	4,85,560	
Voluntary retirement compensation not included in cost Accounts	16,76,540	56,36,246
		2,10,64,888
<i>Less</i> : Interest income from inter-corporate deposit	6,15,340	
Difference in value of cement taken for own Consumption	17,534	
Difference in valuation of windmill power	13,35,955	
Non-operating Income	45,36,770	
Insurance claim relating to previous year	14,35,620	79,41,219
Profit as per Cost Accounts		1,31,23,669

Working :

Figure in ₹

Computation in difference in Valuation of Stock

	Financial Accounts	Cost Accounts
Opening (WIP & FG)	2,91,09,835	3,14,84,660
Closing (WIP & FG)	4,15,35,070	4,72,61,495
	1,24,25,235	1,57,76,835

The increase is higher in Cost Accounts and hence Cost Accounts profit would be more than the financial accounts profit by (₹ 1,57,76,835- ₹ 1,24,25,235) i.e. ₹ 33,51,600

- Q. 4. (a)** Is it mandatory to submit Performance Appraisal Report to the Company Management or can it be a NIL report? Can Form III relating to Performance Appraisal be modified or it has to be strictly followed as prescribed?
- (b)** How would you treat repairs and maintenance Costs resulting from abnormal circumstances as per CAS-12?
- (c)** Based on the following information in respect of GRINDING MILLS LTD. a concern manufacturing cement, you as a Cost Auditor, are required to offer your comments on
- (i) The performance of the company
 - (ii) Your suggestions for improvements

	Rated Capacity 80 MT/Hr	
	2011-2012	2010-2011
(1) Breakdown (Hrs)	2175	1105
(2) Planned maintenance (Hrs.)	252	435
(3) Power restrictions (Hrs)	1236	1475
(4) Shortfall (there are no order)(Hrs)	792	665
(5) Want of wagons (Hrs)	480	646
(6) Total Stoppage (Hrs)	4935	4326
(7) Total running (Hrs)	3972	4635
(8) Total available (Hrs)	8907	8961
(9) Production during the year (MT)	2,57,380	3,36,950
(10) Hourly Rate Production (MT)	64.80	72.70
(11) Capacity utilization	64.35%	84.24%
(12) Annual Installed Capacity : 400000 MT		

[7+2=9]

Answer 4. (a)

Vide sub-rule 5 of Rule 4 of the Companies (Cost Audit Report) rules, 2011, every cost auditor, who submits a cost audit report shall also furnish Performance Appraisal Report, duly authenticated by the cost auditor, to the Board/Audit Committee of the company in the prescribed format (Form III). There cannot be NIL report since list of the areas to be covered in the report as per Form III are relating to Company's operations being audited by the cost auditor. However, the frequency of this report viz. half yearly/annual (or even quarterly) is to be decided by the Company Management.

The contents of the Performance Appraisal Report as given in Form III are "indicative". Depending on the nature of business and activity of the company, the management and the cost auditor in consultation with each other can add or delete the indicative areas to be covered under the Performance Appraisal Report. The intention of the law appears to assign a rule to the cost auditor to provide an independent view of the performance of the company to enable the management to take corrective steps wherever necessary. The Institute is also going to bring out a Guidance Note on the subject.

Answer 4. (b)

As per CAS -12, any repairs and maintenance Cost resulting from some abnormal circumstance, if material and quantifiable, shall not form part of the repairs and maintenance Cost. Example: Major fire explosions, flood and similar events are abnormal circumstances referred above.

Answer 4. (c)**GRINDING MILLS LTD.****Performance of the Company :**

(i) Hourly Rate of Production M.T.

2011-2012	64.80 MT
2010-2011	72.70 MT
Rated Capacity =	80 MT/Hr

Rated Capacity achieved in 2011-2012 = $64.80/80 \times 100 = 81\%$

Rated Capacity achieved in 2010-2011 = $72.70/80 \times 100 = 90.88\%$

Thus the capacity achieved as a percentage of the rated capacity has come down from 90.88% to 81% in 2011-2012

(ii) Capacity Utilization percentage

2011-2012	64.35%
2010-2011	84.24%

The capacity utilization has gone down from 84.24% in 2010-2011 to 64.35% in 2011-2012

(iii) From the data available, the following observations are noted :

- Breakdown hours have gone up 1105 Hrs in 2010-11 to 2175 Hrs in 2011-12 i.e. by 96.83%
- Planned maintenance Hrs has reduced from 435 Hrs in 2010-11 to 252 hrs. in 2011-2012: 42.07%
- Shortfall Hrs due to number of orders has increased from 665 Hrs to 792 Hrs by 27%
- The total stoppage Hrs has increased from 4326 Hrs to 4935 Hrs i.e. by 14.08%
- The total running hrs has come down to 4635 Hrs to 3972 Hrs i.e. by 14.30%
- The production has come down from 336950 MT to 257350 MT i.e. by 23.62%

From the above findings, it is ascertained that the under utilization of capacity to the extent of 20% can be attributed mainly to the

- Increase total stoppage hrs of 4935 Hrs in 2011-12 as against that of 4326 Hrs in 2010-11.
- The net increase of 609 hrs (i.e. 4935-4326) hrs is again due to the increase of break down hrs by 1070 hrs (i.e. 2175-1105) hrs in the year 2011-12 over 2010-11.

Further from the given data, it is noted that :

	2011-2012	2010-2011
Breakdown (Hrs)	2175	1105
Total stoppage (Hrs)	4935	4326
Percentage of Breakdown (Hrs)	44.07%	25.54%

Thus the performance has deteriorated steeply in the year 2011-12 as compared to the performance in the year 2010-11.

Suggestions :

The management is advisable to :

- Augment its planned maintenance with a view to reducing breakdown hours.
- Installed Power Generation sets with a view to compensate the Hours lost due to Power restriction.

SECTION - II (50 Marks)
(Operational Audit)

Q. 5. (a) State whether the following statements are TRUE or FALSE with justification for your answer. No credit will be given for merely answering TRUE or FALSE — without giving any justification/reasoning :

- (i) Dumping is an 'illegal' practice
- (ii) GATT and its agreement are permanent.
- (iii) There are no fixed items of evidence to be checked by Management Auditor.
- (iv) Three-fourths of the members of the Audit Committee shall be independent directors. [1×4=4]

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

- (i) The Secretariat of WTO is headed by a _____ .
- (ii) Quality Review Board (QRB) consists of a Chairperson and _____ other members.
- (iii) ISO 9000 Certification is an _____ service.
- (iv) _____ is needed to create a Corporate Culture of transparency.
- (v) The origin of the term "Due Diligence" owes to _____ . [1×5=5]

(c) What do the following abbreviations stand for?

- (i) MTA;
- (ii) TPRB;
- (iii) CFC;
- (iv) TRIPS;
- (v) CERA. [1×5=5]

Answer 5. (a)

- (i) **FALSE.**
'Dumping' is an 'unfair' practice.
- (ii) **FALSE.**
GATT is an adhoc body and its agreements are all provisional.
- (iii) **TRUE.**
A Management Auditor has to rely more on his experience and acumen to identify areas of review.
- (iv) **FALSE.**
2/3rd of the members of the Audit Committee shall be independent Directors.

Answer 5. (b)

- (i) Director – General
- (ii) Four
- (iii) Assurance Service
- (iv) Corporate Governance.
- (v) US Securities Act, 1933.

Answer 5. (c)

- (i) MTA : Multilateral Trade Agreements.
- (ii) TPRB : Trade Policy Review Body
- (iii) CFC : Certified Facilitation Centre.
- (iv) TRIPS : Trade-Related Aspects of Intellectual Property Rights.
- (v) CERA : Central Revenue Audit.

- Q. 6. (a)** What do you mean by the term “Due Diligence”? What are the areas Due Diligence ought to investigate? [4+3=7]
- (b)** What is meant by ‘Social Responsibility Management’? Briefly list the different types of Pollution for which a manufacturing Company is responsible. [3+5=8]
- (c)** State briefly the adequacy of Budgetary Control System
- (i) in the area of Co-ordination; and
 - (ii) in the area of Control [3]

Answer 6. (a)

Due Diligence : The term ‘Due Diligence’ is generally used for a number of concepts involving the performance of an act with a certain standard of care and caution. At its simplest, due diligence means care and precaution. In this sense, due diligence in workplace means taking every precaution to protect the health, safety and welfare of all workers and staff.

Due Diligence primarily means ‘background checking’ or the intense examination of a target asset for an acquisition by a prospective buyer. It is done to ensure that the buyer has all the information to take the necessary decision.

The main objective of Due Diligence is to verify the assertions made by the seller and to identify caveats, if any that may not have been disclosed by the seller. It can also be described as the task of carefully confirming all critical assumptions and facts presented by a buyer or borrower and to ensure that no material facts are omitted.

In other words, it is a reasonable investigation about the state of affairs of the business to be acquired, especially focusing on matters which may have a critical bearing on the future of the business. In short, the Buyer determines through Due Diligence that the proposed bought out acquisition contains all the assets and liabilities that have been paid for.

Areas to be investigated :

The due diligence process (framework) can be divided into nine distinct areas :

1. **Compatibility audit** deals with the strategic components of the transaction and in particular the need to add shareholder value.
2. **Financial audit** is the verification of the financial statements of a legal entity, with a view to express an audit opinion.
3. **Macro-environmental audit** examines six main areas, the detail depending on the involvement of the business and involvement required by the industry-Demographics, Economic, Environmental, Technology, Political and cultural.

4. **Legal-environmental audit**- Environmental law governs any environmental issues regarding individuals, businesses, and government entities. Environment law includes regulations and cleanup regarding hazardous or chemical materials and the consequences of individuals who violate environment statutes.
5. **Marketing Audit**- Carrying out the marketing audit provides the opportunity to review and appraise the whole marketing activity, enabling the company to assess past and present performance as well as to provide the basis for evaluating possible future courses of action.
6. **Production Audit**- The main objective of production audit is to verify whether the company is to turn out finished goods of requisite quality by making an optimum use of men, machine, and services.
7. **Management audit** - is analysis and assessment of competencies and capabilities of a company's management in order to evaluate their effectiveness, especially with regard to the strategic objectives and policies of the business. The objective of a management audit is not to appraise individual executive performance, but to evaluate the management team in relation to their competition.
8. **Information systems audit** - An information system (IS) audit or information technology(IT) audit is an examination of the controls within an entity's Information technology infrastructure. These reviews may be performed in conjunction with a financial statement audit, internal audit, or other form of attestation engagement.
9. **Reconciliation audit** which links/consolidates other audit areas together via a formal valuation in order to test whether shareholder value will be added.

Answer 6. (b)

Social responsibility describes the duty of care that corporations, governments, charities and institutions all have to their stakeholders.

To keep the confidence of customers, employees, shareholders and a growing array of other organizational stakeholders management need to establish a meaningful framework embedding responsible decision making into all of activities.

Social responsibility is an ethical or ideological theory that an entity whether it is a government, corporation, organization or individual has a responsibility to society at large. This responsibility can be "negative", meaning there is exemption from blame or liability, or it can be "positive," meaning there is a responsibility to act beneficently (proactive stance).

The term "corporate social responsibility" came into common use in the late 1960s and early 1970s after many multinational corporations formed the term stakeholder, meaning those on whom an organization's activities have an impact. Development business ethics is one of the forms of applied ethics that examines ethical principles and moral or ethical problems that can arise in a business environment. Although the Government have enacted legislations for prevention of pollution and provision of safety measures, the company on its own should take measures for community development besides protection of environment.

The level of pollution varies with the density of population and per capita income and inversely with the extent of recycling, technology and waste treatment. The different types, cause and effects of environmental pollution may be as follows:-

(a) **Air pollution :**

Air pollution is the human introduction into the atmosphere of chemicals, particulates or biological materials that cause harm or discomfort to humans or other living organisms or damage the environment. Air pollution is caused by burning coal or crude oil like naphtha in power stations,

smoke from factories, exhaust fumes from automobiles, solvent losses and agricultural chemicals, etc. Air pollution leads to deaths and respiratory diseases.

(b) **Water pollution :**

Water pollution is the contamination of water bodies such as lakes, rivers and/or oceans caused by effluents from breweries and tanneries, coal washeries, chemical plants, discharge of coolants from nuclear power plants, pesticides and agricultural chemicals. Water pollution affects public health and safety, causes damage to property and leads to many economic losses.

(c) **Noise pollution :**

Noise pollution is a type of energy pollution in which distracting, irritating or damaging sounds are freely audible and is caused by noise due to running of heavy machines, big aircrafts, drilling machines, etc. Noise pollution may lead to loss of efficiency at work, loss of hearing and causes psychological disorders, even insanity.

(d) **Smell pollution :**

Discharge of industrial products, unclear garbage dumps, open sewers, etc. It affects physical well being and even causes psychological disorders.

(e) **Thermal pollution :**

Large inputs of heated water from a single plant or a number of plants using the same lake or slow-moving stream can have harmful effects on aquatic life. Thermal pollution is radiation of heat generated by plants in industries. Warmer temperatures lower dissolved oxygen content and cause aquatic organisms to increase their respiration rates consume oxygen faster and increases their susceptibility to disease, parasites, and toxic chemicals. Thermal pollution affects ecological balance and thereby the inhabitants.

(f) **Visual pollution :**

Effluents from chemical plants and washeries are discharged into the waterways causing reduced visibility. Industrial fumes and dust causing loss of landscape attractiveness and strain to vision of pedestrians and motorists, may cause more road accidents and traffic deaths.

(g) **Climate pollution :**

Radiation of heat in highly industrial centres leading to “micro climate zones” causing deforestation, shortening plants growth and affecting surroundings. It affects ecological balance and causes damages to plant and surroundings.

(h) **Radiation pollution :**

Radioactive fallouts, leakage from nuclear reactors and prolonged exposures to small doses of radiation results in a bio-accumulative process, causes a significant chronic affect by increasing the rate of genetic mutation.

(i) **Soil/land pollution :**

Indiscriminate use of fertilizers and pesticides, pollution of soil with man-made chemicals, indiscriminate disposal of solid use etc. Due to pollution the quality of soil deteriorates to the extent that they fail to support vegetation. It affects the global climate also.

Answer 6. (c)

(i) In the area of coordination :

1. Whether the Budget monitoring committee holds the meetings regularly with a view to ensure performance evaluation.
2. Whether it helps to prevent waste that results in duplicate or gross purpose activities.
3. Whether it reveals time lines in the process of preparation and approval of all functional Budgets and Master Budgets.

(ii) In the area of control :

1. Whether system exists for measuring, comparing and qualifying the results of all functional areas;
2. Whether the Budget incorporates a degree of flexibility with a provision of its periodical review;
3. Whether the various reports are issued in time and appropriate corrective action is taken on their variances.

Q. 7. (a) Enumerate ten statutory and specific fields of audit, verification and Certification open to Cost Accountants in practice other than Cost Audit. Indicate a reference to the concerned authority/statute under which the work is prescribed. [6]

(b) Explain whether the following activities amount to Professional Misconduct :

- (i) Mr. D.P. Murarka a practicing Cost Accountant gives a certificate of cost of product manufactured by M/s. Subhomoy Pvt. Company owned by Mr. R.P. Murarka who is son of Mr. D.P. Murarka.
- (ii) Mr. B. M. Balabir Singh a Cost Accountant takes voluntary retirement from his employer in Jalandhar and starts practice. He continues his association with his previous employer in Jalandhar as an adviser, on a monthly retainer.
- (iii) Mr. G. S. Kulkarni, Cost Accountant in practice in Agra holds personal discussions/correspondence with prospective client relating to his achievement and capabilities.

[2×3=6]

(c) State the role of the Audit Committee.

[6]

Answer 7. (a)

Apart from Cost Audit Under Section 233B of the Companies Act, 1956, the statutory and specific fields of Audit, verification and certification open to cost Accountants in practice are enumerated below :

- (i) Central Excise Audit U/s 14A of Central Excise Act, 1944 and Central Excise Special Audit U/s 14AA of the Central Excise Act, 1944.
- (ii) Cost Audit-Co-Operative Sector, U/S 90 (1A) (1B) of West Bengal Co-Operative Societies Act, 1983 (Amendment Act, 1990) and U/s 81 (2A) & (B) of the Amended Maharashtra Co-Operative Societies, 1960.
- (iii) Internal Audit-to comply with the requirement of para 4 (a) (xv) of MAOCARO regarding Internal Audit and Government of Punjab, Department of Finance as per Finance Budget-Branch, Circular April, 1993, Paper 303, Government of Tamil Nadu, A.P. and Orissa dt. 03.09.92, 20.10.93 and 10.01.94 respectively.

- (iv) Stock Audit for Banks-Canara bank Circular No. INSW/IPS/64/484/93 dt. 10.03.93 Indian Bank Circular No. CPGD/CPGD/1197/95 dt. 25.02.95 UBI, SBI, UCO and other different Bank and different circulars.
- (v) Concurrent Audit-Letter dated BOP/Institute/84/1B/509 dated 30.07.1984 from AIFI.
- (vi) Income Tax-Appearing before IT as AT as AR-U/S 288 (2) (v) of IT Act, 1961 and Rule 49 and 50 (3) of IT Rule, 1962 (CBDT Notification No. SO 719 dt. 23.03.1970)
- (vii) Customs- As A.R before Customs, C.E. & Gold Control Appellate Tribunal and Other Authorities-Customs Act, 1962, U/S 146A and Customs (Appellate) Rules, 1982, Rule 9.
- (viii) Wealth Tax-Recognized for Registering as a value of stock, share and debenture as per Wealth Tax (Second Amendment) Rules, 1988, Rule No. 8a(7).
- (ix) Sales Tax/VAT Audit
- (x) Telecom Regulatory Authority of India (TRAI) Audit.
- (xi) Special Audit under Customs Act.
- (xii) Management and Operational Audit etc.
- (xii) Service Tax Audit
- (xiv) Anti-Dumping.

Answer 7. (b)

- (i) The Second schedule to the Cost Accountants Act 1959 stipulates that a Cost Accountant in practice shall be deemed to be guilty of professional misconduct if he expresses his opinion on cost or pricing statements of any business or enterprise in which he or his firm or a partner in his firm has a substantial interest, unless he discloses the interest also in his report. Strictly speaking, a Cost Accountant issuing a certificate for a unit in which he has no direct interest is in order. However, in this case M/s Subhomoy Pvt. Company is owned by R.P. Murarka who is son of D. P. Murarka, it would be prudent on the part of D. P. Murarka to desist from issuing such a certificate on the moral ground.
- (ii) As Mr. B.M. Balabir Singh a Cost Accountant has connection with his previous employer and acts only in an advisory capacity, which is a legitimate activity of a Practising Cost Accountant, it does not amount to misconduct.
- (iii) Holding personal discussions/correspondence with prospective clients relating to his achievements and capabilities is permitted and does not amount to professional misconduct.

Answer 7. (c)

Role of Audit Committee : The role of the Audit Committee shall include the following :

- (i) Oversight of the company's financial reporting process and the disclosure of it is financial information to ensure that the financial statement is correct, sufficient and credible.
- (ii) Recommending to the Board, the appointment, re-appointment and if required, the replacement or removal of the statutory auditor and the fixation of audit fees.
- (iii) Approval of payment to statutory auditors for any other services rendered by the statutory auditors.
- (iv) Reviewing, with the management, the annual financial statements before submission to the Board for approval.
- (v) Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems. Reviewing the adequacy of the internal audit function.

- (vi) Reviewing the findings of any internal investigations, where there is suspected fraud or irregularity.
- (vii) Post-audit discussion with statutory auditors.
- (viii) To look into the reasons for substantial defaults in the payment to the depositors, debenture holders and creditors.
- (ix) Carrying out any other function, as mentioned in the terms of reference of the Audit Committee.

Q. 8. Write answer any three from the following :

- (a) Cost Audit and Assurance Standards Board;
- (b) Safeguard Duty;
- (c) Concurrent Audit;
- (d) Objectives of Operational Audit.

[6×3=18]

Answer 8. (a)

COST AUDIT AND ASSURANCE STANDARDS BOARD :

The Institute of cost Accountants of India (ICAI) is committed to the goal of enabling the cost and management accounting profession in India to provide services of high quality in the public interest as per the international standards. ICAI has developed and promulgated technical standards and other professional literature to realize this goal. The ICAI being one of the founder members of the IFAC, the standards are being developed and promulgated by the Cost Audit and Assurance Board (CAAB) under the authority of the council of ICAI are in conformity with the corresponding international standards issued by the International Auditing and Assurance Standards Board (IAASB) established by IFAC.

The primary objectives of CAAB is to identify the areas in which standards on Quality Control and Engagement Standards are required to be developed after reviewing the existing and emerging audit practices worldwide.

It serves the public interest by formulating and setting high quality auditing and assurance standards.

It demonstrates to the regulators, investors, businesses community, interested third parties. It provides support and guidance to help audit firms to develop and improve their practices.

It takes up a programme of practice review which applies to all practicing members in India who hold a certificate of practice (COP) of ICAI.

Answer 8. (b)

SAFEGUARD DUTY :

Safeguard Duty is a step in providing a need based protection to domestic industry for a limited period with ultimate objective of restoring free and fair competition. Central Government is empowered to impose 'safeguard duty' on specified imports. If it is satisfied that goods are being imported in large quantities and are causing serious injury to domestic industry. Such duty is permissible under WTO agreement, only condition is that discrimination cannot be done among imports from different Most Favoured Nations.

Government has to conduct an enquiry and then issue notification under Sec 8B (1) of Custom Tariff Act. Total period of duty cannot be more than 10 years under Section 8B (4) of Customs Tariff Act. Once imposed the duty is valid for 4 years unless revoked earlier. In case of imports from developing countries, such duty can be imposed only if value is more than 3% of total imports of the article in India under Sec 8B(10) of Custom Tariff Act.

Answer 8. (c)

CONCURRENT AUDIT :

Concurrent audit is a systematic examination of financial transactions on a regular basis to ensure accuracy, authenticity and compliance with procedures and guidelines. It is an examination, which is contemporaneous with the occurrence of transactions or is carried out as near thereto as possible. The main focus of this audit is to ensure that transactions adhere to the system and laid down procedures. It serves the purpose of effective internal control as it reduces the time gap between occurrence of a transaction and its overview or checking. The concurrent audit is similar in nature to internal audit as both are generally initiated by the management itself. However, there is basic difference between the two i.e. concurrent audit is regular audit of financial transactions whereas internal audit is a periodic audit.

Sound internal controls are essential to the prudent operation of banks and to promote stability in the financial system as a whole. Concurrent Audit ensures that adequate internal controls within banking organizations are supplemented by an effective internal audit function, which independently evaluates the control systems within the organization. Concurrent Audit of Bank Branches involves checking of all aspects of banking and other operations on an ongoing daily basis to ensure that the Branch is adhering to the Bank's laid down systems and procedures. The Concurrent Auditors are responsible to examine and comment on all the areas specified by the Bank/RBI from time to time in regard to concurrent audit of branches. A copy of guidelines on the manner of conduct of audit is also provided at the time of allotment of concurrent audit and from time to time thereafter. Therefore, it ensures that all errors and frauds, if any are generally detected immediately after their occurrence to control the damage, if any.

Answer 8. (d)

OBJECTIVES OF OPERATIONAL AUDIT :

The scope and quality of operational auditing is predominantly dependent upon management attitudes. An open minded management with broad vision, can appreciate the need of operational auditing and to give it the necessary freedom and sanction to perform what it is capable of performing. Also, the qualities and the sense of perspectives of the operational auditor can mould operational audit in the right shape. Therefore, there is a possibility of operational auditing having different objectives to fulfil in different considerations. Generally, operational audit objectives include :

- (i) **Appraisal of controls** : The most significant gain an organization can derive from operational auditing is probably in the area of appraisal of controls. Internal controls, because of their unobtrusive omnipresence in the organization, provide the essential hinges to ensure proper performance in each functional or organizational area for accomplishing the desired organizational objective.
- (ii) **Evaluation of performance** : In performance appraisal, the operational auditor is basically concerned not so much with how well technically the operations are going on, but with accumulating information and evidence to measure the effectiveness, efficiency and economy with which the operations are being carried on. The principal basis of performance evaluation can be productivity, personnel, workload, cost and quality. In the area of productivity, the operational auditor can undertake such tests as input-output ratios for materials and labour in quantitative terms.
- (iii) **Appraisal of objectives and plans** : Everything in an organization is the product of basic plans and objectives set by the management. If the management policy favours installation of controls or specifies the extent of controls whether satisfactory or not, control would have to stay within the

policy frame. Therefore, the basic thing that should be evaluated is management policies, plans and objectives. Operational auditor may look into the aspects like whether objectives are clearly spelt out and properly communicated to the personnel responsible for implementation and whether the personnel have understood the objectives in the sense meant by the management. Also, he can take note of any apparent conflict in the objectives for its effect on operations.

- (iv) **Appraisal of organizational structure :** Organizational structure provides the line of relationship and delegation of authority and tasks. This is an important element of the internal control design. Therefore, this is also another important area for appraisal by the operational auditor. In evaluating organizational structure, the aspects that may be considered by the operational auditor whether the organizational structure is in conformity with management objectives and is drawn up on the basis of matching of responsibility and authority.