FINAL EXAMINATION

GROUP IV

(SYLLABUS 2008)

SUGGESTED ANSWERS TO QUESTIONS

JUNE 2013

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.
Working notes should form part of the answer.

Please: (i) Answer all bits of a question at one place.
(ii) Open a new page for answer to a new Question.
(iii) 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):**

(i) Rule 6 of the Companies (Cost Accounting Records) Rules 2011 provides that Compliance Report is to be submitted to the Central Government within

A. 180 days from the close of the Company's financial year
B. 120 days from the close of the Company's financial year
C. 90 days from the close of the Company's financial year
D. 60 days from the close of the Company's financial year

(ii) CAS-13 deals with

A. Cost of Service Cost Centre
B. Employee Cost
C. Pollution Control Cost
D. Repair and Maintenance Cost

(iii) Profit reconciliation for the Company as a whole is dealt in

A. Para 8 of the annexure to Cost Audit Report under Companies (Cost Audit Report) Rules 2011
B. Para 7 of the annexure to Cost Audit Report under Companies (Cost Audit Report) Rules 2011
C. Para 6 of the annexure to Cost Audit Report under Companies (Cost Audit Report) Rules 2011
D. Para 4 of the annexure to Cost Audit Report under Companies (Cost Audit Report) Rules 2011

(iv) Form A XBRL is used for filing

A. Cost Audit Report of a Company
B. Annual Report of a Company
C. Compliance Report of a Company
D. Annual Accounts of a Company

(v) The main purpose of 'efficiency Audit' is to ensure that
A. Every rupee invested gives optimum returns
B. Planned expenditure gives optimum returns
C. Various policies of management are implemented
D. Activities of business are beneficial to Society at large

(vi) Para 10 of the annexure to Cost Audit Report under Companies (Cost Audit Report) Rules 2011 deals with
A. Installed Capacity and Actual Production
B. Capital employed
C. Related Party transactions for the Company as a whole
D. Reconciliation of Indirect taxes for the Company as a whole

(vii) Cost Audit was initially introduced in the year
A. 1959
B. 1960
C. 1965
D. None of the above

(viii) CAS-5 deals with
A. Equalized Cost of Transportation
B. Captive Consumption
C. Cost of Utilities
D. Cost of Service Cost Centre
1x8=8

(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:

(i) XBRL (extensible Business Reporting Language) is a language based on XBL family of languages.

(ii) Cost Audit in India appears to be Synonymous with Efficiency Audit.

(iii) As per CAS-12, fines, penalties, damages and similar levies paid to Statutory Authorities or third parties shall form part of repair and maintenance cost.

(iv) A concurrent auditor of a Company can accept appointment as the Cost Auditor of the same Company.

(v) The Costing Taxonomy and related Business Rules including sample instance documents can be downloaded from the website of the Institute of Cost Accountants of India (ICAI).

(vi) 'Performance Appraisal Report' is a part of Cost Audit Report for filing in XBRL. 1 x6=6

Answer 1.

(a)
(i) A
(ii) A
(iii) B
(iv) C
(v) A
(vi) C
(vii) C
(viii) A

(b) (i) FALSE: XBRL (eXtensible Business Reporting Language) is a language based on XML (eXtensible Markup Language) family of Languages.

(ii) TRUE: Cost Audit appears to be synonymous with Efficiency Audit.

(iii) FALSE: As per CAS – 12, Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall no form part of repairs and Maintenance Cost.

(iv) FALSE: A Concurrent auditor may be viewed as a person holding an office of Profit of the Company and so he cannot be appointed as the Cost Auditor of the same Company.

(v) FALSE: The Costing Taxonomy and related business Rules including sample instance documents can be downloaded from the website of MCA (Ministry of Corporate Affairs)

(vi) False: "Performance Appraisal Report" is a part of Cost Audit Report and submitted to the company stating the performance of the company and it is not uploaded for XBRL.

2. (a) The following is the abridged Balance Sheet of SARATHI LTD., a single product manufacturing Company:

Year ended 31st March	**2013**	**2012**
	(Amount in ₹ Lakh)	
LIABILITIES:		
Share Capital	**600**	**600**
Reserves & Surplus:		
Debenture Redemption Reserve	**50**	**60**
Capital Subsidy from State Government	**60**	**60**
Revaluation Reserve	**250**	**280**
General Reserve	**320**	**240**
Profit & Loss A/c	**96**	**64**
Secured Loans:	**550**	**590**
Unsecured Loans:	**246**	**234**
Total:	**2172**	**2128**

Year ended 31st March	**2013**	**2012**
	(Amount in ₹ Lakh)	
ASSETS:		
Gross Block	**1450**	**1360**
Accumulated Depreciation	**(630)**	**(580)**
Net Block	**820**	**780**
Capital Work-in-Progress	**86**	**74**
Investments:	**30**	**30**
Current Assets, Loans & Advances:		
Inventories	**834**	**882**
Sundry Debtors	**364**	**390**
Advances for Equipments	**48**	**34**
Other Loans & Advances	**288**	**274**
Cash and Bank Balances	**42**	**38**
Current Liabilities & Provisions:		
Sundry Creditors for Capital Expenses	**(34)**	**(42)**
Sundry Creditors for Others	**(370)**	**(394)**
Provision for Taxes	**(128)**	**(142)**
Miscellaneous Expenditure	**192**	**204**
Total:	**2172**	**2128**

Additional information is available:

(i) Term Loans repayable in 12 months included under 'Secured Loans' are ₹ 192 lakh (Previous year ₹ 168 lakh).

(ii) Profit before Tax (PBT) for the year ended March 31, 2013 is ₹ 160 lakh (Previous year ₹ 174 lakh).

You are required to compute the following figures/ratios as stipulated in PARA 9 of the Annexure to Cost Audit Report under Companies (Cost Audit Report) Rules 2011, for the year ended March 31, 2013:

(i) Capital Employed;

(ii) Net Worth;

(iii) Debt-Equity Ratio;

(iv) PBT to Capital Employed;

(v) PBT to Net Worth. **5+3+2+1+1=12**

(b) 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. **2x3=6**

Answer 2.

(a) **SARATHI LTD**

(i) Capital Employed	Amount in ₹ Lakh			
			31.03.2013	31.03.2012
Gross Block			1450	1360
Less: Depreciation			630	580
Net Block			820	780
Less: Revaluation Reserve			250	280
Net Fixed Assets			570	500
Current Assets: (A)	31.3.2013	31.3.2013		
Inventories	834	882		
Sundry Debtors	364	390		
Loans and Advances	288	274		
Cash and Bank	42	38		
	1528	1584		
Current Liabilities: (B)				
Creditors – others	370	394		
Provisions for taxes	128	142		
Loans due in 12 months	192	168		
	690	704		
Working Capital (A-B)	838	880	838	880
CAPITAL EMPLOYED			1408	1380

Average Capital Employed: (1408+1380)/2 = ₹ 1394 lakh

Capital Employed for the year ended March 31, 2013: ₹ 1394 lakh

(i) Net worth	Amount in ₹ lakh 31.03.2013
Share Capital	600
Debenture Redemption Reserve	50
Capital Subsidy	60
General Reserve	320
Profit & Loss A/c	96
Equity	1126
Less: Miscellaneous Expenditure	192
Net Worth	934
(ii) Debt – Equity Ratio	Amount in ₹ lakh 31.03.2013
Debt: Secured Loans	550
Unsecured Loans	246
	796
Less: due in 12 months	192
	604
Equity as in above (ii)	1126
Debt-Equity Ratio (604 ÷ 1126) X 100	53.64% or, 0.5364:1
(iii) PBT to Capital Employed: ₹ (160 ÷1394) lakh x 100	11.48%
(iv) PBT to Net worth: (160 ÷ 934) x 100	17.13%

(b) (i) In case of Leased Assets, if the Lease is an operating lease, the entire rentals shall be included in the administrative overheads. If the lease is a financial lease, the finance cost portion shall be segregated and treated as part of finance costs.

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

(iii) The Cost of Software (developed in house, purchased, licensed or customized) including upgradation Cost shall be amortised over its estimated useful life.

3. (a) What is eXtensible Business Reporting Language (XBRL)? What are the applications of XBRL? 2+3=5

(b) Who can authenticate the Compliance Report as per the Companies (Cost Accounting Records) Rules 2011? 4

(c) (i) What are 'Waste Multipliers' in Textile Costing?

(ii) The following details of the process-wise input and output are taken from the Cost Accounting Records of SUNNY COTTON MILLS LTD., a yarn manufacturing Company, for the year ended March 31, 2013:

Process	Input / Output	Kgs.
Blowroom	Cotton processed	46,72,560
	Laps produced	42,58,270
Carding	Laps processed	42,74,360
	Slivers produced	39,76,400
Draw frames	Slivers processed	39,48,240
	Slivers drawn	39,01,800
Roving (Simplex)	Drawn Slivers processed	38,74,120
	Transferred to Ring Frames	38,31,500
Ring Frames (Spinning)	Slivers used	39,11,640
	Finished Yarn produced	36,41,740
	Yarn wound	36,35,400
Reeling and Winding	Salable Yarn produced	35,80,880

Required:

Calculate the process-wise Waste Multiplier factors for the year ended March 31, 2013. **2+7=9**

Answer 3.

(a) XBRL (eXtensive Business Reporting Language) is a Language based on XML (eXtensible Markup Language) family of Languages. It is an open Standards – based reporting system that is built to accommodate the electronic preparation and exchange of business reports around the world using internet as a Medium. It has been defined specifically to meet the requirements of Business and Financial information. It enables unique identifying tags to be applied to items of accounting data. The tags provide a range of information about the item such as whether it is a monetary item, percentage or fraction. XBRL not only allows labels in any language to be applied to items, it also allow the accounting references or other subsidiary information to be added to the tags.

XBRL can be applied to a very wide range of business applications including financial and Cost data. XBRL has applications in the following areas:

- Reporting for internal and external purposes by an entity involving financial and costing data information.
- Business reporting to all types of regulators, including tax and financial Authorities, Central Banks and Government.
- Filing of Loan reports and applications, credit risk assessments
- Exchange of information between Government departments, Institutions and banks.

(b) As per Rule 5 of the Companies (Cost Accounting Records) Rules 2011 the Compliance Report and the annexure thereto is required to be certified by a "Cost Accountant" as defined under Rule 2(c).

As per Rule 7, the annexure to the Compliance Report is to be duly approved by the Board of Directors.

A "Cost Accountant" within the definition of these Rules does not include.

a) A Member holding a part-time certificate of practice, or
b) A Member who is in full time employment whose membership fees are in arrears or
c) A Member of the Institute of Cost Accountants of India who has been admitted as a member through reciprocal arrangement of membership by virtue of being a member of Institute of Management Accountants, USA.

(c) (i) **Waste Multipliers:** Under Section 209(1)(d) Rules for the Textile Industry, the process-wise Cost/kg of output is being worked out at first. Then these Costs are aggregated to arrive at the total yarn cost. As there are wastes at each process, the final aggregation of process to arrive at the finished yarn has to take into Account all such process wise wastages. This is done by using a factor known as a Waste Multiplier. Accordingly waste multiplier is that quantity of output from any process which will be needed to get one unit of final output.

(ii)

SUNNY COTTON MILLS LTD

CALCULATION OF WASTE MULTIPLIER

Process	Input (Kgs)	Output (Kgs)	Loss on Input	Output (%)	Waste Multiplier factor
Total Consumption				100	1.3161
Blow room	4672560	4258270	8.87	(100-8.87)=91.13	1.1994
Carding	4274360	3976400	6.97	(91.13-6.35)=84.78	1.1158
Draw Frames	3948240	3901800	1.18	(84.78-1.00)=83.78	1.1026
Roving (Simplex)	3874120	3831500	1.10	(83.78-0.92)=82.86	1.0905
Ring Frames (Spinning)	3911640	3641740	6.90	(82.86-5.72)=77.14	1.0153
Reeling and Winding	3635400	3580880	1.50	(77.14-1.16)=75.98	1.0000

Working Notes:

1. Blow room = 100-8.87 = 91.13
   Carding = 91.13-(91.13x6.97%) = 91.13-6.35 = 84.78
   Draw Frames = 84.78 x 0.0118 = 1.00
   Roving (Simplex) = 83.78 x 0.0110 = 0.92
   Ring Frames = 82.86 x 0.0690 = 5.72
   Reeling & Winding = 77.14 x 0.0150 = 1.16

2. Waste Multiplier:

   75.98 ÷ 75.98 = 1.0000

   77.14 ÷ 75.98 = 1.0153

   82.86 ÷ 75.98 = 1.0905

   83.78 ÷ 75.98 = 1.1026

   84.78 ÷ 75.98 = 1.1158

   91.13 ÷ 75.98 = 1.1994 etc.

4. (a) The Cost Accountant of SOVANA SUGAR MILLS LTD. has arrived at a profit of ₹ 73,24,150 based on Cost Accounting records for the year ended March 31, 2013. As Cost Auditor, you find the following differences between the Financial Accounts and Cost Accounts:

(i) Decrease in value of Closing WIP and Finished goods inventory		
as per Financial Accounts	**₹ 128,21,995**	
as per Cost Accounts	**₹ 131,04,220**	
(ii) Profit on Sale of Fixed Assets		**₹ 61,500**
(iii) Loss on Sale of Investments		**₹ 11,200**
(iv) Voluntary Retirement Compensation included in Salary & Wages in F/A		**₹ 16,75,000**
(v) Donation Paid		**₹ 25,000**
(vi) Major Repairs & Maintenance written off in F/A (Amount reckoned in Cost Accounts of ₹ 6,08,420 for this job)		**₹ 13,26,000**
(vii) Insurance Claim relating to previous year received during the year		**₹ 14,29,000**
(viii) Profit from Retail trading activity		**₹ 7,12,300**
(ix) Interest Income from Inter-Corporate Deposits		**₹ 6,15,000**

You are required to prepare a Reconciliation Statement and arrive at the Profit as per Financial Accounts. 4+3+1+1=9

(b) Answer the following questions with respect to Companies (Cost Accounting Records) Rules 2011:

(i) Are there any sectors exempted under Companies (Cost Accounting Record) Rules 2011?

(ii) What constitutes the Cost records under Rule 2(e)? Whether the format of 'Abridged Cost Statement' prescribed in the Companies (Cost Audit Report) Rules 2011 can be considered as a Sample Cost Statement? 2+3=5

(c) Answer the following questions with reference to CAS-14:

(i) How is cost computed if Pollution Control Jobs are carried out by outside contractors?

(ii) How is cost determined if Pollution Control Jobs are carried out by contractor at its premises? 2x2=4

Answer 4.

(a)

SOVANA SUGAR MILLS LTD.

RECONCILIATION OF FINANCIAL PROFIT AND COSTING PROFIT
FOR THE YEAR ENDED MARCH 31,2013

Particulars	Amount (₹)	Amount (₹)
Profit as per cost accounting records		73,24,150
(1) Add: Incomes not considered in Cost Accounts:		
(i) Profit and sale of Fixed Assets	61,500	
(ii) Insurance claim received relating to previous year	14,29,000	
(iii) Profit from retail trade activity	7,12,300	
(iv) Interest income from Inter-Cooperative deposits	6,15,000	
		28,17,800
(2) Less: Expenses not Considered in Cost Accounts		
(i) Loss and sale of investments	11,200	
(ii) Voluntary Retirement Compensation included in Salary & Wages	16,75,000	
(iii) Donation Paid	25,000	
(iv) Part of repairs and maintenance cost excluded in Cost Accounts (1326000-608420)	7,17,580	(24,28,780)
(3) Add: Difference in valuation of stock		
Decrease in inventory as per Cost Accounts	1,31,04,220	
Decrease in inventory as per Financial A/c	(1,28,21,995)	
Valuation in Financial Accounts in higher		2,82,225
PROFIT AS PER FINANCIAL ACCOUNTS		79,95,395

(b) (i) MCA General Circular No. 67/2011 dated 30th November 2011 states that the Companies (Cost Accounting Records) rules 2011 are not applicable to wholesale and retail trading, banking, financial, leasing, investment, insurance, education, healthcare, tourism, travel, hospitality, recreation, transport services business / professional Consultancy, IT and IT enabled Services, research and development, Postal / Courier Services etc.

Unless any of these have been specifically covered under any other Cost Accounting Records Rules.

(ii) Books of Account and other records relating to utilization of materials, labour and other items of cost that provides data / information to compute the cost of production, cost of sales and margin of each of the products / activities of the company on monthly / quarterly / half yearly / annual basis are considered part of the cost records. It includes statistical, quantitative and other records which enable the company to exercise, as far as possible, control over the various operations and costs with a view to achieve optimum economics in utilization of resources. Cost records are required to be maintained on continuous basis from basic stage of input to the final output. There cannot be any exhaustive list of Cost records. This could depend on the materiality of Cost components in the cost of product / activity.

The abridged cost statement can be used as a sample cost statement. This may be modified according to the need of the company.

(c) (i) As per CAS-14 Cost of Pollution Control Jobs carried out by outside contractors shall include charges made by the contractor and cost of own materials, consumable stores, spares, manpower, equipment usage, utilities and other cost used in such jobs.

(ii) As per CAS-14, Cost of pollution Control Jobs carried out by contractor at its premises shall be determined at invoice or agreed price including duties and taxes and other expenditure directly attributable thereto net of discounts (other than cash discount) taxes and duties refundable or to be credited.

This cost shall also include the cost of other resources provided to the contractor.

SECTION II (50 Marks)
(Operational Audit)

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:

(i) The Consumer Service Audit critically examines the outstanding payment of consumer.

(ii) GATT and its agreement are permanent.

(iii) Sarbanes-Oxley Act of 2002 is a U.K. Federal Law enacted on July 30, 2002.

(iv) Interest Cost should be included in inventory valuation for purposes of Bank Audit.

(v) Management Audit Report is to be submitted to the Cost Audit Branch of Central Government. **1 x5=5**

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

(i) Management Audit requires ________ approach.

(ii) Excise-Audit-2000 was initiated from _________ .

(iii) Section 292A of the Companies (Amendment) Act 2000, provides for Constitution of ___________.

(iv) India had to remove ________ on imports as per WTO stipulations.

(v) ______________ is transfer of goods to an alien market at a price which is less than marginal cost of its production in the home country.

(vi) Central Excise Revenue Audit (CERA) is conducted by the organization of_____. **1x6=6**

(c) What do the following abbreviations stand for?

(i) OECD;

(ii) CEGAT;

(iii) TPRM. **1x3=3**

Answer 5.

(a) (i) FALSE: The Consumer Service Audit critically examines and appraised management of responsibility of a business enterprise towards consumers at right time, in right quantity at the right place and price.

(ii) FALSE: GATT and its agreements are provisional

(iii) FALSE: Sarbanes-Oxley Act of 2002 is a United States Federal Law enacted on July 30, 2002.

(iv) FALSE: Interest cost is finance cost and is to be excluded for valuation of inventories.

(v) FALSE: Management Audit Report is to be submitted to the Management of the concern and not to the Cost Audit Branch of Central Government.

(b) (i) Inter-disciplinary

(ii) 1st December 1999

(iii) Audit Committees

(iv) Quantitative restrictions

(v) Dumping

(vi) Comptroller and Auditor General of India

(c) (i) OECD: Organisation for Economic Co-operation and Development

(ii) CEGAT: Central Excise and Gold Control Appellate Tribunal

(iii) TPRM: Trace Policy Review Mechanism

6. (a) What do you understand by 'Corporate Image' and 'Branding'? Are they inter-related? What are the possible approaches to evaluate Corporate Image? 4+1+4=9

(b) What is the scope of work for a Cost Accountant as a Loss Assessor under the Insurance Act? Give an illustrative list of the types of claims and points to be considered in assessing the quantum of loss. 2+5+2=9

Answer 6.

(a) **Corporate Image:**

The term "Image" indicates an idea or procure formed in the mind of a person about an individual or an institution. Corporations, like individuals, consciously build up images in the minds of the people with whom they come into contract. In developing a 'Corporate Image', an enterprise has to ensure an overall consistency, as regards the quality of the products, the ethics of its management, employee relations, attitudes towards customers, quality and service to customers etc. the Public have different perceptions of "Corporate Image".

- Customers measure it by the product quality, prompt and courteous after sales service, regularity in maintaining supplies; etc.
- Shareholders, measure it by the consistency in financial performance and prospects of growth.
- Supplier measure it by the company's liquidity and ability to honour commitments.
- Banks and Financial Institutions measure it by the financial health, net worth and history of servicing debts.
- Government looks at it from the point of view of revenue generation and as an honest tax payer.
- Employees look for steady career growth and smooth Industrial Relations.

Corporate Branding:

Corporate branding is the process of creating and maintaining a favourable reputation of the company and its constituent elements. It is an important organizational resource that enable to create, strengthen and sustain competitive advantage. It is a strategic asset that creates competitive advantage and favourable climate for survival and development of an organization.

The purpose of corporate branding is to:

- Make the organization known as unique, distinct and creditable in the mind of potential customers.
- Facilitate the building of relationships and trust.
- Portray the benefits of the organization to the customer

Yes. Both Corporate Image and Branding are interrelated concepts. The factors which contribute to build up a 'corporate image' also substantially help in building a 'corporate branding'.

Evaluation of Corporate Image

Evaluation of Corporate Image is a very complex process and it involves a critical examination of events and trends concerning business environment – both internal as well as external.

The following are the steps to evaluate Corporate Image.

- Prepare a list of desirable attributes.
- Group them functionally and specify the qualifications
- Assign weights to each attribute based on their relative importance.
- Involve experts in the respective fields in rating the qualifications and attributes – based on facts, judgments and interpretations.
- Summarise the rating under the selected groups and present a composite evaluation to the management.

The summary should throw light on what the company has been able to do for itself and for the public in general.

(b) The Controller of Insurance, Government of India, has recognized the Cost Accounting qualification as equivalent to "additional technical qualification" for grant of license under section 64 UM of the Insurance Act for appointment as a Surveyor or Loss Assessor.

There are various types of general insurance policies such as:

Fire	Fidelity guarantee
Marine	Malicious damages
Accident,	Natural calamities like Floods, cyclones etc.
Loss of Profit,	Cash-in-transit.
Cash in safe, etc., etc,	

Marine policy also includes inland transit by road or rail. 'A surveyor should thoroughly study the terms and conditions of the policy and understand the types of risks covered, restrictions on claims, conditions to be fulfilled by the policyholder etc. For example, in the case of fire insurance the insured should have taken adequate precautions for prevention of fire, proper storage of goods or equipment: Loss generally arise due to any one of the following reasons.

a) **Marine Insurance.**
   - Loss in transit due to leakage, pilferage etc.,
   - Damage in transit due to accident on improper packing
   - Strikes, riots or civil commotion

b) Fire – Loss of stocks, Plant and Machineries
   - Substantial damage

c) Accident – Accident to vehicles
   Accident within plants (e.g., explosion in chemical factory)

d) Malicious damage – Willful damage to equipment by militant trade unions or political parties.
e) Fidelity guarantee – Misappropriation of cash by cashier.
f) Loss of profit – due to closure of the factory and consequent drop in production.
g) Cash in Transit - Cash carrying from the Bank/office to the factory/mill and/or bank to bank and vise-versa etc.
h) Cash in safe-cash misappropriated by the cashier and/or outside parties etc.

In all the above cases, the surveyor should assess the quantum of loss strictly as per the conditions stipulated in the policy. Insurance surveyors measure, assess and report on the insured's financial losses or damages. Their report is the basis on which the insurers compensate the insured. A Cost Accountant – with his specialized training in the operational aspects of the business organization and especially his in-depth knowledge of the financial implications of the activities involved can play an effective role in assessing, the actual quantum of loss and also estimate the loss of profit and assist in the settlement of claims.

7. (a) Your client, ASHEETA LTD. is contemplating to take over a manufacturing concern and desires that in the course of due diligence review, you should look specifically for any hidden liabilities and overvalued assets.
—State (in brief) the major areas you would examine for the above. 2+4+4=10

(b) Management Audit and Operational Audit are Complementary and Supplementary to one another.—Discuss. 4

(c) Explain whether the following activities amount to professional misconduct on the part of a Cost Accountant:

(i) F. B. HORE & CO., a firm of Cost Accountants was appointed by a Company to evaluate the Costs of the various products manufactured by it for its information system. One of the partners of the firm was a Non-Executive Director of the Company.

(ii) CMA DEBOSMITA, a practicing Cost Accountant, takes up a job as a full time lecturer in a College affiliated to University of Calcutta. 2+2=4

Answer 7.

(a) Due diligence is an all pervasive exercise to review all important aspects like financial, legal, commercial, etc. before taking any final decision in the matter. As far as any hidden liabilities or overvalued assets are concerned, this shall form part of such a review. Normally, cases of hidden liabilities and overvalued assets are not apparent from books of accounts and financial statements. Review of financial statements does involve examination from the view point of extraordinary items, analysis of significant deviations, etc. However, in order to investigate hidden liabilities, the auditor should pay his attention to the following areas:

- Any show cause notice, which have not m=matured into demands but may be material and important.
- Contingent liabilities not shown in books.
- Letters of comforts given to banks and financial institutions.
- Company may have sold some subsidiaries/businesses and may have agreed to take over and indemnify all liabilities and contingent liabilities of the same prior to the date of transfer.
- Product and warranty liabilities, product returns & discounts, liquidated damages, etc.
- Tax liability under direct and indirect taxes
- Long pending sales tax assessment.
- Cases of custom duty where only provisional assessment has been made and final assessment is yet to completed.
- Agreement to buy back shares at a stated price.
- Future lease liabilities.
- Claims against the company including third party claims.
- Unfunded retirement benefit of employees.
- Labour claims under negotiations.

Regularly Overvalued assets: The auditor shall have to specifically examine the following areas:

- Uncollectable receivables.
- Obsolete, slow and non-moving inventories and inventories valued above net realizable value, if any.
- Obsolete and unused plant and machinery and their spares.
- Assets value which have impaired due to sudden fall in market value.

- Assets shown in books above market value due to capitalization of expenditure / foreign exchange fluctuation or capitalization of revenue expenditure.
- Assets under litigation.
- Investment shown at cost whose market value is much lower.
- Investment carrying very low rate of return.
- In fructuous project expenditure.
- Intangibles of no value.

(b) Management Audit is that it is wider in scope compared to operational audit. Management Audit is concerned with the quality of managing, where as Operational Audit centers on the quality of operation.

The basic difference between the two audits is not in method, but in the level of appraisal. In Management Audit, the auditor is to take his tests to the level of top management, its formulations of objectives, plan and policies and its decision making. It is not that he just verifies the operation of Control and procedure and fulfillment of plans in conformity with the prescribed policies. Thus the two audits are complementary and supplementary to any another.

(c) (i) clause 4 of Part-I of the Second Schedule to the Cost and Works Accountants Act, 1959 states that expressing an opinion on cost and pricing of any business or any enterprise in which the auditor or his firm or a partner in his firm has a substantial interest would constitute misconduct, unless he discloses the interest also in his report. As per the facts of the case, the firm has been retained to evaluate the cost of products manufactured by it for its information system. So this amounts to Professional misconduct.

(ii) Clause 10 of Part-I of the Fist Schedule to the Cost and Works Accounts Act, 1959 prohibits a member in practice to engage in any business or occupation other than the profession of Cost Accountant unless permitted by the council so to engage. Such prohibition has been introduced as it would not be in keeping with the dignity of the profession and may also enable the member to secure an unfair advantage in his professional practice. In the instant case, CMA Debosmita has accepted the appointment of lecturer ship without obtaining specific and prior approval of the council. Accordingly, CMA Debosmita would be held guilty of Professional misconduct.

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

(a) International Auditing and Assurance Standard Board (IAASB);

(b) Consumer Services Audit;

(c) Difference between Financial and Operational Auditing;

(d) Environmental Pollution;

(e) **Safeguard Duty.** **6x3=18**

Answer 8.

(a) **The International Auditing and Assurance Standards Board (IAASB)** is an independent standard-setting body that serves the public interest by setting high-quality International standards for auditing, assurance and other related standards and by facilitating the convergence of International and National Auditing and Assurance Standards. In doing so, the IAASB enhances the quality and consistency of practice throughout the world and strengthens public confidence in the global auditing and assurance profession.

The IAASB's Strategy and Work Program, 2012-14 sets the direction and priorities for its activities. The IAASB's efforts are focused on development, adoption and implementation of International Standards addressing audit, quality control review, other assurance and related services engagements.

The IAASB develops and issues the following:

- International Standards on Auditing (ISAs) and International Standards on Review Engagements (ISREs) to be applied in audit and review engagements on historical financial information.
- International Standards on Assurance Engagements (ISAFs) to be applied in assurance engagements other than audits or reviews of historical financial information.
- International standards on Related Services (ISRSs) to be applied in related services engagements.
- International Standards on Quality Control (ISQs) to be applied for all services falling within the engagement Standards of the IAASB.
- Practice Statements as appropriate to provide interpretive guidance and practical assistance in implementing the Standards of the IAASB and to promote good practice.

The IMSB develops auditing and assurance standards, other pronouncements, and guidance under a shared standard-setting process involving the Public Interest Oversight Board (PIOB). The PIOB oversees the work of the IAASB and its CAG to ensure that the activities of the IAASB are responsive to the public interest.

(b) **CONSUMER SERVICES AUDIT:**

The basic responsibilities of a business organization towards consumers are to make available products of the right qualities, at the right time, in right quantity, at the right place and the right price. The kind of audit, which critically examines and appraises management performance on these aspects of services, may be called as "consumer services audit". Thus, it is an audit of public, responsibility of a business enterprise in relation to its customers and is a part of social audit.

The conceptual approach of this audit is based on the philosophy that the role of business should be conducive to raising the quality of life through its contribution in terms of better product quality and better services.

The following are some of the important aspects/questions, which the auditor must address:

- Do the products manufactured meet the needs of the customers of different classes, different tastes and different purchasing power?
- Are the product prices reasonable and consistent with the quality variations, efficiency variations and reasonable profit margin?
- Is the share of 'added value' through increased profitability reasonably passed down to the consumer?
- Whether after-sales service, spare parts facility, etc., enable the customers to derive maximum use and pleasure?
- What are the efforts made to constantly improve the product and its use value, esteem value?

- Are the company policies and practices in regard to the distribution of products among different sections of customers fair and equitable?

(c) **DIFFERENCE BETWEEN FINANCIAL AND OPERATIONAL AUDITING:**

The major differences between financial and operational auditing can be described as follows:

(i) Purpose – The financial auditing is basically concerned with the opinion that whether the historical information recorded is correct or not, whereas, the operational auditing emphasizes on effectiveness and efficiency of operations for future performance.

(ii) Area – Financial audits are restricted to the matters directly affecting the appropriateness of the presented financial statements but the operational auditing covers all the activities that are related to efficiency and effectiveness of operations directed towards accomplishment of objectives of organization.

(iii) Reporting – The financial audit report is sent to all stock holders, bankers and other persons having stake in the Organisation. However, the operational audit report is primarily for the management.

(iv) End Task – The financial audit has reporting the findings to the persons getting the report as its end objective, however, the operational auditing is not limited to reporting only but includes suggestions for improvement also.

The main objective of operational auditing is to verify the fulfillment of plans, and sound business requirements. Operational auditing is considered as specialized management information tool. Operational auditing is essentially a function of internal auditing staff. Operational auditing is a systematic process of evaluating an organisation's effectiveness.

(d) ENVIRONMENTAL POLLUTION:

Environmental Pollution means smoke from industries, effluents from chemical plants, noise from heavy machines and vehicles, unclear garbage dumps etc. The concept of pollution embraces environmental problems-such as air and water pollution, noise and loss of open space as nuisances that contribute to the deterioration of the quality of life-both human and other living organisms.

Pollution is a kind of interference to the environment and causes environmental degradation. The problems of environmental de-gradation-air, water, noise and visual pollution, solid wastes, radiation hazards, thermal pollution, threats to wild-life, depletion and destruction of natural resources, etc., are all 'Environmental crisis" and 'threats to the delicate balance'.

Environmental Pollution' Now constitutes one of the biggest hazards. It is the biggest hazards not only to human existence of all the gifts that nature has so kindly bestowed on mankind. Rapid industrialization and ever-increasing urbanization have resulted in the environmental problems, assuming alarming proportions.

The problems of environmental pollution are extremely acute in the developed and developing countries. Even with the availability of improved methods and stringent laws, the problems are far from being solved. Thus, 'protection and preservation of environment has to be looked at, encouraged and developed as a people's movement' world over.

(e) SAFEGUARD DUTY:

Safeguard Duty is a step in providing a need based protection to domestic industry for a limited period with ultimate objective of resorting free and fair completion. 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 import 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 88(4) of Customs Tariff Act. Imposed 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(IO) of Custom Tariff Act.