

FINAL EXAMINATION

(REVISED SYLLABUS - 2008)

GROUP - IV

Paper-17 : COST AUDIT & OPERATIONAL AUDIT

Section I : Cost Audit

- Q. 1. (a) Choose the most correct answer among four alternative statements :
- (i) Para 6 of the Annexure to Cost Audit Report, 2011 deals with :
 - (A) Product group details.
 - (B) Quantitative information of each product group separately.
 - (C) Operating ratio analysis for each product group separately.
 - (D) Abridged cost statement for each product group separately.
 - (ii) Rectified Spirit is covered by
 - (A) Cost Accounting Records(Chemical Industries) Rules, 2004
 - (B) Cost Accounting Records(Formulations) Rules, 1988
 - (C) Cost Accounting Records(Industrial Alcohol) Rules, 1997
 - (D) Cost Accounting Records(Bulk Drugs) rules,1974
 - (iii) Application for appointment of Cost Auditor should be sent to Department of Company Affairs within
 - (A) 30 days of commencement of financial year.
 - (B) 45 days of commencement of financial year.
 - (C) 90 days of commencement of financial year.
 - (D) 60 days of commencement of financial year.
 - (iv) A Cost Auditor should 'qualify' the Cost Audit Report where :
 - (A) He is unable to form an opinion due to non availability of appropriate records/data.
 - (B) He finds that items in the cost statements are mistated.
 - (C) None of the above.
 - (D) Both of the above
 - (v) Rate per unit for each product group under para 5 of the annexure to Cost Audit Report, 2011 to be furnished for :
 - (A) last year only.
 - (B) current year and previous 2 years.
 - (C) current year and previous year.
 - (D) previous three years.

- (vi) 'Significant influence' means :
- (A) Participation in the financial policy decisions and control but not operating policy decisions and control of an enterprise.
 - (B) Participation in the financial or operating policy decisions of an enterprise and control over those policies.
 - (C) Participation in the financial or operating policy decisions of an enterprise but not control over those policies.
 - (D) None of the above.
- (vii) Copy of Cost Audit Report need not be submitted to
- (A) Company Law Board
 - (B) Members at Annual General Meeting of the Company
 - (C) Board of Directors of the Company
 - (D) Income Tax Officer along with the Income tax Return.
- (viii) The Compliance Report is to be issued by the certifying Cost Accountant in :
- (A) Form A of the 2011 Record Rules.
 - (B) Form B of the 2011 Record Rules.
 - (C) Form C of the 2011 Record Rules.
 - (D) None of the above.
- (ix) Rule 6 of the 2011 Record Rules provides that Compliance Report is to be submitted to Central Government within :
- (A) 180 days from the close of the company's financial year.
 - (B) 90 days from the close of the company's financial year.
 - (C) 120 days from the close of the company's financial year.
 - (D) 60 days from the close of the company's financial year.
- (x) CAS 13 deals with :
- (A) Packing Material Cost
 - (B) Cost of Utilities
 - (C) Pollution Control Cost
 - (D) Cost of Service Cost Centre

Q. 1. (b) Fill in the blanks :

- (i) Cost Audit was initially introduced in the year _____ .
- (ii) The ceiling on number of Cost Audits to be under taken by a Cost Auditor is laid down in Section _____ of Companies Act.
- (iii) Detailed provisions relating to Cost Audit are contained in Section _____ of the Companies Act.
- (iv) Each Cost Accounting Record rule is given a _____ number and date of publication in the Gazette.
- (v) As per CAS 12, fines, penalties, damages and similar levies paid to statutory authorities or third parties _____ form part of repair and maintenance cost.
- (vi) Outward transportation cost, as per CAS 5 shall form part of cost of _____ .

- (vii) Para 10 of the annexure to Cost Audit Report Rules, 2011 deals with _____ for company as a whole.
- (viii) CERA (Central Excise Revenue Audit) is conducted by the organization of _____ .
- (ix) Soda Ash is covered by Cost Accounting Records _____ Rules.
- (x) Value addition is the difference between _____ and the cost of bought out materials and services.

Answer 1. (a)

- (i) (C) Operating ratio analysis for each product group separately.
- (ii) (C) Cost Accounting Records (Industrial Alcohol) Rules, 1997.
- (iii) (B) 45 days of commencement of financial year.
- (iv) (B) He finds that items in the cost statements are mistated.
- (v) (C) current year and previous year.
- (vi) (C) Participation in the financial or operating policy decisions of an enterprise but not control over those policies.
- (vii) (B) Members at Annual General Meeting of the Company.
- (viii) (B) Form B of the 2011 Record Rules.
- (ix) (A) 180 days from the close the company's financial year.
- (x) (D) Cost of Service Cost Centre.

Answer 1. (b)

- (i) 1965
- (ii) 224(1B)
- (iii) 233B
- (iv) GSR
- (v) shall not
- (vi) sale
- (vii) Related Party Transactions
- (viii) Comptroller and Auditor General
- (ix) Chemical
- (x) net sales

Q. 2. (a) Define Cost Audit, How it is useful :

- (I) To the Management
- (II) To the Society
- (III) To the Shareholders, and
- (IV) To the Government?

(b) Explain the Social objectives of Cost Audit.

Answer 2. (a)

The Institute of Cost Accountants of India defines cost audit as “a system of audit introduced by the Government of India for the review, examination, and appraisal of the cost accounting records and attendant information, required to be maintained by specified industries.” According to CIMA, London, cost audit is “the verification of the correctness of cost accounts and of adherence to the Cost Accounting plan.” Thus cost audit comprises of :

- (i) the verification of the cost accounting records such as the accuracy of the cost accounts, cost reports, cost statements, cost data, costing techniques and
- (ii) examining these records to ensure that they adhere to the cost accounting principle, plans, procedures and objectives.

Usefulness of Cost Audit :

Cost audit is useful to the management, society, shareholders and the government as shown below.

(I) Usefulness to the Management :

- (i) The management gets reliable data for its day to day operations like price fixing, control, decision making, etc.
- (ii) A close and continuous check on all wastages is kept through a proper system of reporting to the management.
- (iii) Inefficiencies in the working of the company is brought to the notice of the management to take corrective action.
- (iv) Management by exception becomes possible through allocation of responsibilities to individual managers.
- (v) The system of budgetary control and standard costing is greatly facilitated.
- (vi) A reliable check in the valuation of closing stock and work-in-progress is established.
- (vii) It helps in the detection of errors and fraud.

(II) Usefulness to the Society :

- (i) Cost audit is often introduced for the purpose of fixation of price. The prices so fixed are based on the correct costing data and so the consumers are saved from exploitation.
- (ii) Price increase by the industry is not allowed without proper justification as to increase in cost of production, consumers are saved from unreasonable price hike.
- (iii) Cost Audit is also useful for the purpose of Cost Control; Cost reduction and proper utilisation of scarce resources.

(III) Usefulness to Shareholders :

Cost audit ensures that proper records are kept as to purchases and utilisation of material and expenses incurred on wages, overheads, etc. It also ensures that the unit has been run economically and efficiently. It also makes sure that the valuation of closing stocks and work-in-progress is on a fair basis. Thus, the shareholders are assured of a fair return on their investment.

(IV) Usefulness to the Government :

- (i) Where the government enters into a cost plus contract, cost audit helps the government to fix the price of the contract.
- (ii) Cost audit helps the fixation of selling prices of essential commodities and thus undue profiteering is checked.
- (iii) Cost audit enables the government to focus its attention on inefficient units.

- (iv) Cost audit enables the government to decide in favour of giving protection to certain industries.
- (v) Cost audit facilitates settlement of trade disputes brought to the government.
- (vi) Since cost audit ensures efficient running of the business and correct and accurate use of cost data, a healthy competition is generated among the various units in an industry. This imposes an automatic check on inflation.

Answer 2. (b)

The social objectives of Cost Audit are as follows:

- (i) Facilitation in fixation of reasonable prices of goods and services produced by the enterprise.
- (ii) Improvement in productivity of human, physical and financial resources of the enterprise.
- (iii) Channelising of the enterprise resources to most optimum, productive and profitable areas.
- (iv) Availability of audited cost data as regards contracts containing escalation clauses.
- (v) Facilitation in settlement of bills in the case of cost-plus contracts entered into by the Government.
- (vi) Pinpointing areas of inefficiency and mismanagement, if any for the benefit of shareholders, consumers, etc., such that necessary corrective action could be taken in time.

Q. 3. (a) Given below is the Trading and Profit and Loss Account of a Company for the year ended 31st March, 2012 :

	₹		₹
To Materials	27,40,000	By Sales	60,00,000
To Wages	15,10,000	(60,000 units)	
To Factory Expenses	8,30,000	By Stock (2,000 units)	1,60,000
To Admn. Expenses	3,82,400	By Work-in- Progress	₹
To Selling Expenses	4,50,000	Materials	64,000
To Preliminary Expenses		Wages	36,000
Written off	60,000	Factory Expenses	20,000
To Net Profit	3,25,600	By Dividend received	18,000
	62,98,000		62,98,000

The Company manufactures standard units. In the Cost Accounts :

- (i) Factory expenses have been allocated to production at 20% of Prime Cost;
- (ii) Administrative expenses at ₹ 6 per unit produced; and
- (iii) Selling expenses at ₹ 8 per unit sold.

Prepare the Costing Profit and Loss Account of the company and reconcile the same with the profit disclosed by the Financial Accounts.

(b) What as a Cost Auditor, will you verify in the area of work-in-progress?

Answer 3. (a)**Costing Profit & Loss Account**

Particulars	₹	Particulars	₹
To Materials (Working Note 1)	26,76,000	By Sales	60,00,000
To Wages (Working Note 2)	14,74,000	By Closing Stock (Working Note 4)	1,72,646
To Factory Expenses (20% of Prime cost viz ₹ 41,50,000) (Refer to Working Note 3)	8,30,000		
To Administration Expenses (@ ₹ 6 p.u. × 62,000 units)	3,72,000		
To Selling Expenses (@ ₹ 8 p.u. × 60,000 units)	4,80,000		
To Net Profit	3,40,646		
	61,72,646		61,72,646

Reconciliation Statement

Particulars	₹	₹
Profit as per Cost Accounts		3,40,646
Add : Dividends not included in Cost Accounts	18,000	
Factory Expenses overabsorbed in Cost Accounts (₹ 8,30,000 ₹ 8,10,000)	20,000	
Selling overheads overabsorbed in Cost Accounts (₹ 4,80,000 – ₹ 4,50,000)	30,000	68,000
		4,08,646
Less : Preliminary expenses not included in Cost Accounts	60,000	
Administrative expenses under absorbed in Cost Accounts (₹ 3,82,400 – ₹ 372,000)	10,400	
Closing stock overvalued in Cost Accounts (₹ 1,72,646 – ₹ 1,60,000) (Refer to Working Note 4)	12,646	83,046
Profit as per Financial Accounts		3,25,600

Working Notes :

- Material = ₹ 27,40,000 – ₹ 64,000 = 26,76,000
- Wages = ₹ 15,10,000 – ₹ 36,000 = ₹ 14,74,000
- Prime Cost = Materials + Wages = ₹ 26,76,000 + ₹ 14,74,000 = ₹ 41,50,000
- Closing Stock Value = $\left(\frac{\text{Material Cost} + \text{Wages} + \text{Factory Expenses} + \text{Admn. Expenses}}{62,000 \text{ units}} \right) \times 2000$
 $= \frac{₹ 53,52,000}{62,000} \times 2,000 = ₹ 1,72,646$

Answer 3. (b)

The Cost Auditor should verify the following area of work-in-progress :

- That the work-in-progress has been physically verified and it agrees with the quantity shown in job-cards of uncompleted work.
- That the valuation of the work-in-progress is correct with reference to the stage of completion of each job or process and the value job cost cards or process cost sheet.
- That there is no over-valuation or under valuation of opening work-in-progress or closing work-in-progress, thereby artificially, pushing up and down net profits or net assets as the case may be.
- That the volume and value of work-in-progress is not disproportionate as compared with finished production.

Q. 4. (a) The input, output and labour costs process-wise are given below :

Process	Input M.T.	Output M.T. the process (₹)	Direct Labour cost of
A	72000	64800	194400
B	75000	66000	264000
C	108000	99360	496800
D	90000	83250	666000

Calculate "Direct labour cost per unit of the product under reference" as required in para 5(4) of the Cost Audit Report.

(b) What points to be kept in view by the Cost Auditor while furnishing information under para 5 of the annexure to the Cost Audit Report under Cost Audit Report Rules, 2011?

Answer 4. (a)

The total labour cost per tonne of the product under audit must be an aggregation of process-wise labour costs after taking into account the good units occurring in each process.

Process	Input	Output	Factor
A	72000	64800	72000/64800 = 1.1111
B	75000	66000	75000/66000 = 1.1364
C	108000	99360	108000/99360 = 1.0870
D	90000	83250	90000/83250 = 1.0811

Process wise labour costs per M.T of output are :

- $194400/64800 = ₹ 3$
- $264000/66000 = ₹ 4$
- $496800/99360 = ₹ 5$
- $666000/83250 = ₹ 8$

Charging all the above to the finished product from process D,

Process A = ₹ 3

Process B = (₹ 3 × 1.1364) + ₹ 4 = ₹ 7.4092

Process C = (₹ 7.4092 × 1.0870) + ₹ 5 = ₹ 13.0538

Process D = (₹ 13.0538 × 1.0811) + ₹ 8 = ₹ 22.1125

Direct Labour cost per M.T. of Finished Product = ₹ 22.11

Answer 4. (b)

The following points are to be kept in view by the Cost Auditor while furnishing information under para 5 of the annexure to Cost Audit Report :

- (i) Separate Cost Statement shall be prepared for each product/activity group.
- (ii) The items of cost shown in the Proforma are indicative and same should be reflected keeping in mind the materiality of the item of cost in the product/activity group.
- (iii) The Proforma may be suitably modified to meet the requirement of the industry/product/activity group.
- (iv) In case the company follows a predetermined or standard costing system, the above cost statement should reflect figures at actual after adjustment of variances, if any.
- (v) Where ever, there is any significant variation in the current year's figure over the previous year's figure for any item shown under each para of the Annexure to the Cost Audit Report, reasons thereof shall be given by the Cost Auditor.
- (vi) If the duration of the current year or previous year is not twelve months, same shall be clearly indicated in the Report.

Q. 5. (a) The following is the abridged Balance Sheet of XYZ Ltd. for the year ended 31st March 2011.

Liabilities	₹ In lacs	Total (₹ in Lacs)	Assets	₹ In Lacs	Total (₹ in Lacs)
Share Capital		11200	Gross Block	115600	
Reserves & Surplus :			Less: Depreciation	31200	84400
General Reserve	25000		Capital WIP		3000
Share Premium	36200		Investments		8800
Revaluation Reserve	13600	74800	Current Assets, Loans & Advances:		
Secured Loan:			Inventories	26400	
Term loan	34400		Sundry Debtors	12800	
Cash Credit	12000	46400	Cash & Bank Balances	2480	
Current Liabilities & Provisions		38000	Advances to suppliers of Equipment	4800	
			Other Advances	17600	64080
			Miscellaneous Expenses carried forward		10120
		170400			170400

The profit after interest provision of ₹ 2600 lacs for the same period was ₹ 7060 lacs. Compute the following figures/ratios as stipulated in para 9 of Annexure to Cost Audit Report (for the company as a whole) :

- (i) Capital employed
 - (ii) Net worth
 - (iii) Net worth as a percentage of long term borrowings and liabilities.
 - (iv) Profit as a percentage of capital employed.
- (b) As a cost auditor what will you verify on the area of 'overheads and indirect expenditure'?

Answer 5. (a)

		₹ in lacs
(i)		
Capital Employed :		
Net Block		84400
Less : Revaluation Reserve		13600
Add : Current Assets	64080	
Less : Advances to suppliers for equipment	4800	59280
Less : Current Liabilities		38000
Total capital employed		92080

		₹ in lacs
(ii)		
Networth :		
Share capital		11200
+ General Reserve		25000
+ Share Premium		36200
Total		72400
Less : Misc. Exp .c/f		10120
		62280

(iii) Net worth as a percentage of long term borrowings :

		₹ in lacs
(i) Networth		62280
(ii) Long term borrowing		34400
(i) as a % age of (ii) $(62280/34400 \times 100)$		181.05%

(iv) Profit as a percentage of capital employed.

		₹ in lacs
Profit after interest		7060
Interest		2600
Profit before interest		9660
Profit as a % age of capital employed = $9660/92080 \times 100$		10.49%

Answer 5. (b)

A cost Auditor must verify the following aspects in the area of 'overheads and indirect expenditure'.

- (i) that allocation of indirect expenditure over production, sales, and distribution is logical and correct;
- (ii) that compared with the value of production in a production shop, the overleaf charges are not excessive;
- (iii) that the actual indirect expenditure does not exceed budgets or standard expenditure significantly and that any variations are satisfactorily explained and accounted for;
- (iv) that the relation of indirect expenditure in keeping with the load on individual production shop is appropriate;

- (v) correctness of appropriate allocation of overhead expenditure (both production and sales) will be certified by Cost Auditor;
- (vi) that allocation of overheads between finished products and unfinished products is in accordance with correct principles.

Q. 6. (a) Explain the relation between installed capacity, practical capacity and normal capacity.

(b) Manufacture's specification capacity for a machine per hour = 1500 units

No. of shifts (each shift of 8 hours each) = 3 shifts

Paid holidays in a year (365 days) :

Sundays 52 days

Other holidays 8

Annual maintenance is done during the 8 other holidays.

Preventive weekly maintenance is carried on during Sundays.

Normal idle capacity due to lunch time, shift change etc=1hour.

Production during last five years = 76.20 , 88, 65.82 , 78.5 , 76.6 lac units.

Actual production during the year = 76.40 units.

Calculate Installed capacity, Available capacity, Actual capacity, Idle capacity and Abnormal idle capacity as per CAS 2 from the data given.

Answer 6. (a)

'Installed Capacity' is the maximum productive capacity according to the manufacturers' specification of machines / equipment. Installed capacity of the unit/plant is determined after taking into account imbalances in different machines/ equipment in the various departments / production cost centres in the unit / plant and number of working shifts.

'Practical or Achievable Capacity' is the maximum productive capacity of a plant reduced by the predictable and unavoidable factors of interruption pertaining to internal causes.

Thus, practical capacity is the installed capacity minus the inevitable interruptions due to time lost for preventive maintenance, repairs, set ups, normal delays, weekly off-days and holidays etc. Practical capacity does not consider the external factors causing reduction in production e.g. lack of orders.

'Normal Capacity' is the production achieved or achievable on an average over a period or season under normal circumstances taking into account the loss of capacity resulting from planned maintenance.

Normal capacity is practical capacity minus the loss of productive capacity due to external factors.

Installed capacity		***
Less, inevitable interruptions due to time lost for internal reasons such as :		
• preventive maintenance	**	
• repairs	**	
• set ups	**	
• normal delays	**	
• weekly off-days	**	
• holidays etc.	**	**
Practical Capacity		***
Less, loss of productive capacity due to external factors.	**	
Normal Capacity		***

Answer 6. (b)

Installed capacity for the machine = $365 \times 8 \times 3 \times 1500$
 = 131.40 lac units

Available capacity = $(365-52-8) \times (8-1) \times 3 \times 1500$
 = $305 \times 7 \times 3 \times 1500$
 = 96.08 lac units

Normal capacity = $(76.2+78.5+76.6)/3$
 = 77.1 lac units.

Actual capacity utilization = 76.4 lac units
 = $76.4/131.4 \times 100$
 = 58.14%

Idle capacity = $(131.40-76.4)$ lac units
 = 55 lac units
 = $55 / 131.4 \times 100$
 = 41.86%

Abnormal idle capacity = $(77.1-76.4)$ lac units
 = 0.70 lac units

Q. 7. (a) How will you treat the following items in the Cost Accounting Records?

- (i) Voluntary Retirement Compensation paid to workers included under 'wages'.
- (ii) CENVAT availed as credit on purchased raw materials.
- (iii) Profit on sale of fertilizers to cane growers by a sugar company.
- (iv) Commission paid to the Managing Director as a percentage of profit.
- (v) Interest received on security deposit with the Electricity Board.

(b) Under utilization of capacity may result from imbalance in production facilities in some areas. Explain the possible reasons of imbalance, with examples. Should a cost auditor make any observations in this regard in the Cost Audit Report?

Answer 7. (a)

- (i) Voluntary retirement is a one time non-recurring expenditure. Even if it is included under salaries and wages in Financial Accounts, it should be excluded for Cost Accounts purposes. This is a item of reconciliation between Cost and Financial Accounts.
- (ii) CENVAT credit is to be deducted from the cost of raw materials , and only the net value should be taken in the priced stores ledger, which forms the basis for pricing material issues to cost centres.
- (iii) This is purely a trading activity. Hence profit derived from such activity should be shown as a item of reconciliation between Financial and Cost Accounts.
- (iv) This is clearly an item to be excluded from cost. This should be shown as an item in the reconciliation between Costing and Financial Profit and Loss Account.

- (v) Interest on security deposit with the Electricity Board can be set-off against interest paid or alternatively, it can be taken as a credit against overheads.

Answer 7. (b)

In a factory production facilities in one section may remain unutilized due to :-

- (I) production capacity of preceding process plant may not be adequate to feed it;
- (II) production capacity of subsequent process plant may not be able to absorb the output. Some examples are produced below :
- In an engineering plant, the assembly line may be completely manual while machine shop department may possess high speed automated machine tools, which may remain idle.
 - In a mini steel plant, steel making capacity may be inadequate to produce billets or ingots required by steel rolling mill forcing the later to remain idle for part of the period.
 - In a textile mill capacity of the spinning mill may not be adequate to feed the high speed looms in the weaving section.

Such imbalances normally occur when modernization in a factory is undertaken in a phased manner. The cost auditor has a statutory obligation to comment on underutilization of capacity in Para 4 of the Annexure to the Cost audit (Report Rules), 2011.

If full installed capacity is not utilized, the matter should be discussed with concerned operating executive and the causes for underutilization should be located. If it is due to imbalance as explained above, the cost auditor should offer suggestions for improvement in performance.

Some of the possible suggestions are as follows:

- (i) If there is excess capacity in an earlier stage- eg. Spinning capacity higher than the requirement of weaving department, the excess production of yarn may be sold in the market; if the weaving capacity is higher, yarn may be purchased from market.
- (ii) In an engineering plant, if the machine shop has excess capacity, job works may be undertaken so that machines are fully utilized; if assembly line is automated, and machine shop is not able to feed it, possibility of subcontracting may be explored.

Q. 8. Answer the following questions with respect to Companies (Cost Accounting Records) Rules, 2011.

- (a) What is the effective date from which Companies (Cost Accounting Records) Rules 2011 come into force?
- (b) What is the status of the 44 Cost Accounting Records Rules issued till the date of issue of Companies (Cost Accounting Records) Rules 2011 and what is its applicability?
- (c) What does turnover mean under these Rules? Is gross turnover Inclusive of excise duty?
- (d) Whether product manufactured for 100% captive / self-consumption shall be covered under the Companies (Cost Accounting Records) Rules 2011?

Answer 8.

- (a) The Companies (Cost Accounting Records) Rules, 2011 have been published vide G.S.R. 429(E) dated 3rd June, 2011. As per sub-rule (2) of Rule 1, these rules have come into force on the date of publication in the Official Gazette.
- (b) The Companies (Cost Accounting Records) Rules 2011 has superseded 36 cost accounting record rules.

The said Rules are applicable to all companies engaged in production, processing, manufacturing and mining activities as defined under Rules 2(j), 2(k), 2(l) or 2(o) respectively and where :

- (i) the aggregate value of net worth as on the last date of the immediately preceding financial year exceeds five crores of rupees; or
- (ii) the aggregate value of the turnover made by the company from sale or supply of all products or activities during the immediately preceding financial year exceeds twenty crores of rupees; or
- (iii) the company's equity or debt securities are listed or are in the process of listing on any stock exchange, whether in India or outside India.

Any company meeting the above criteria would be required to maintain cost accounting records and file a Compliance Report in the prescribed format from financial year commencing on and from 1st April 2011.

These Rules are not applicable to a company which is a body corporate governed by a Special Act.

Further, the Companies (Cost Accounting Records) Rules 2011 is not applicable to activities or products covered in any of the following rules :

- (a) *Cost Accounting Records (Bulk Drugs) Rules, 1974*
- (b) *Cost Accounting Records (Formulations) Rules, 1988*
- (c) *Cost Accounting Records (Fertilizers) Rules, 1993*
- (d) *Cost Accounting Records (Sugar) Rules, 1997*
- (e) *Cost Accounting Records (Industrial Alcohol) Rules, 1997*
- (f) *Cost Accounting Records (Electricity Industry) Rules, 2001*
- (g) *Cost Accounting Records (Petroleum Industry) Rules, 2002*
- (h) *Cost Accounting Records (Telecommunications) Rules, 2002*

In case a company is engaged in activities, in addition to the activities covered by the above 8 Rules, such activities shall be covered under the Companies (Cost Accounting Records) Rules 2011.

- (c) As per Rule 2(p), "Turnover" means gross turnover made by the company from the sale or supply of all products or services during the financial year. It includes any turnover from job work or loan license operations but does not include any non-operational income. From a reading of the Rules, it appears that the word "Gross" denotes "total". Hence, the "Turnover" under these Rules would exclude duties and taxes.
- (d) The test of inclusion under the Rules is whether it is a production, processing, manufacturing or mining activity resulting in a product [for definition of "product" refer to Rule 2(m)] intended for use, consumption, sale, transport, store, delivery or disposal and whether the company carrying out the activity falls within the criteria mentioned under Rule 3(1). If the company meets requirement of Rule 3(1), the activity – whether or not for captive/self- consumption – will come under the ambit of these Rules.

Q. 9. Answer the following in respect of Companies (Cost Audit Report Rules) 2011.

- (a) What is the effective financial year from which Cost Audit Order No. 52/26/CAB-2010 dated 24th January 2012 is applicable?
- (b) Whether film industry like film producing companies/studios registered under Indian Companies Act covered under Companies (Cost Accounting Records) Rules, 2011?
- (c) Will the companies subject to cost audit be also required to file Compliance Report under these Rules?
- (d) How and in what manner a cost auditor is required to sign a cost audit report?

Answer 9.

- (a) The Cost Audit Order No. 52/26/CAB-2010 dated 24th January 2012 is applicable on a company engaged in industry/activity listed in the order in respect of each of its financial year commencing on or after 1st April, 2012.

Examples :

- (i) A company under company specific cost audit order having financial year 1st April to 31st March. The company will be subject to cost audit till financial year ending 31st March 2012 under company specific cost audit order and from financial year 2012-13, the company will be subject to cost audit under industry specific order.
- (ii) A company under company specific cost audit order having financial year 1st January to 31st December. The company will be subject to cost audit till financial year ending 31st December 2012 under company specific cost audit order and from financial year commencing on 1st January 2013, the company will be subject to cost audit report under industry specific order.

In both the above cases, the company should meet the threshold limits as prescribed (Regulated Industry or Non-Regulated Industry) at the time of first application of industry specific cost audit order.

- (b) Companies (Cost Accounting Records) Rules, 2011 is applicable to developing, fixing, and washing exposed photographic or cinematographic film or paper to produce either a negative image or a positive image. In case a film producing company is also engaged in these activities, the same would be covered.
- (c) Every company covered under Companies (Cost Accounting Records) Rules 2011 is required to file a Compliance Report irrespective of whether all or any of its products are covered under cost audit. Thus the Compliance Report shall include product groups covered under cost audit as well as product groups not covered under cost audit.
- (d) In case where a firm of cost accountants is appointed as cost auditors, the Cost Audit Report shall be signed by any one of the partners of the firm responsible for the conduct of cost audit in his own hand along with his membership number, for and on behalf of the firm.

In case where an individual is appointed as cost auditor, the Cost Audit Report shall be signed by the individual cost auditor in his own hand along with his membership number.

- Q. 10. (a) Who can authenticate the Compliance Report as per the Companies (Cost Accounting Records) Rules 2011?**
- (b) Is there any ceiling on the number of Compliance Reports which can be authenticated by a practicing cost accountant or a cost accountant in permanent employment of the company?**
- (c) For how many years, does a company under these rules require to preserve the Cost details?**

Answer 10. (a)

As per Rule 5, as per the Companies (Cost Accounting Records) Rules 2011 the Compliance Report and 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:

- (i) A member holding a part-time certificate of practice; or
- (ii) A member who is in full time employment whose membership fees are in arrears;
- (iii) 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.

Answer 10. (b)

There is no ceiling on the number of Compliance Reports that can be authenticated by a cost accountant in whole-time practice. A cost accountant working as permanent employee can authenticate the Compliance Report of the company where he is employed provided his membership dues are not in arrears. He cannot authenticate Compliance Report of any other company even under the same group.

Answer 10. (c)

In respect of companies coming under the purview of the Companies (Cost Accounting Records) Rules, 2011 and the Companies (Cost Audit Report) Rules, 2011 for the first time, cost records and cost details, statements, schedules, etc. shall be kept in good order for the next eight financial years beginning with first year of application of the said Rules.

Q. 11. Comment on the following :

- (i) A company has not maintained cost accounting records though having the obligation under 209(1)(d) notification. The management is of the opinion that necessary steps could be taken after the cost audit order is received from Government. Are the Directors of the Company absolved of the obligation to maintain cost accounting records?**
- (ii) A company receives the Cost Audit report for a period after filing of the Income Tax Return. Is the company required to submit a copy of the report to the ITO? If yes, what is the period by which the Report must be so filed?**
- (iii) During plant stoppages, the operational labour is being utilized by the company for cleaning, oiling, and such other routine jobs of the same plant. Their wages for the period also are treated as direct wages in cost of production.**
- (iv) Sugar mills use bagasse as fuel in the boilers. One sugar mill has not valued bagasse as according to the management it has incurred no cost in acquiring it. What is the requirement under 209(1)(d) regulations relating to sugar?**

Answer 11.

- (i)** The obligation to maintain cost accounting records as per the rules provided under Section 209(1)(d) is a continuing one independent of whether cost audit is ordered or not. The financial auditor also has an obligation to certify under CARO that such records have been maintained. The directors of the company cannot be absolved of the obligation as per the Rules 3 and 4 of the 209(1)(d) regulation.
- (ii)** Sections 139(9)(e) of the Income Tax Act, 1961 requires the filling of the Cost Audit Reports along with the Income Tax return wherein an audit is ordered. Where the cost audit report is delayed beyond the date for filing of the IT Return, the Company is bound by law to submit a copy of the report to the IT authorities. There is no time limit specified for this. This must be done within a reasonable time as per general construction of law.
- (iii)** Where operating workers are required to perform certain type of work which otherwise falls in the category of indirect labour, like oiling, cleaning, maintenance etc., their wages should be treated as indirect wages and accordingly be included in overhead.
- (iv)** Bagasse is a by product in sugar industry, which has a realizable value. As the company is using bagasse as a fuel to produce steam, the bagasse should be valued at its realizable value. In absence of a market price, bagasse may be valued on the basis of average pithead price of coal after converting the weight of bagasse into equivalent coal adopting a thermal equivalency.

Q. 12. (a) What do you understand by the term 'Pollution Control' as per CAS 14?

(b) How is social cost of pollution measured?

(c) How should Pollution Control cost be presented in Cost Statement?

Answer 12. (a)

Pollution Control means the control of emissions and effluents into environment. It constitutes the use of materials, processes, or practices to reduce, minimize, or eliminate the creation of pollutants or wastes. It includes practices that reduce the use of toxic or hazardous materials, energy, water, and / or other resources.

Answer 12. (b)

Social costs of pollution are measured by economic models of cost measurement. The cost by way of compensation by the polluting entity either under future legislation or under social pressure cannot be quantified by traditional models of cost measurement. They are best kept out of general purpose cost statements.

Answer 12. (c)

Pollution Control cost, if material, shall be presented in the cost statement as a separate item of cost.

Pollution control costs shall be presented duly classified as follows :

- (i) Direct and Indirect cost
- (ii) Internal and External costs
- (iii) Current and future costs
- (iv) Domain area e.g. water, air and soil.

Activity wise details of Pollution Control cost, if material, shall be presented separately.

Q. 13. (a) What do you understand by the term 'collection of overheads' as per CAS 3?

(b) What is the value of Goods used for captive consumption as per CAS 4?

(c) What do you understand by the term 'service cost centre' as per CAS 13?

(d) How are 'inward' and 'outward' transportation cost treated as per CAS 5?

Answer 13. (a)

Collection of overheads means the pooling of indirect items of expenses from books of account and supportive/ corroborative records in logical groups having regards to their nature and purpose.

Overheads are collected on the basis of pre-planned groupings, called cost pools. Homogeneity of the cost components in respect of their behaviour and character is to be considered in developing the cost pool. Variable and fixed overheads should be collected in separate cost pools under a cost centre. A great degree of homogeneity in the cost pools are to be maintained to make the apportionment of overheads more rational and scientific. A cost pool for maintenance expenses will help in apportioning them to different cost centres which use the maintenance service.

Answer 13. (b)

According to the Central Excise Valuation (Determination of Price of Excisable Goods) Rules 2000, the assessable value of goods used for captive consumption is 110% w.e.f. 05-08-2003 of cost of production of such goods, and as may be prescribed by the Government from time to time. (Originally it was 115%)

Answer 13. (c)

The cost centre which provides services to Production, Operation or other Service Cost Centre but not directly engaged in manufacturing process or operation is a service cost centre. A service cost centre renders services to other cost centres / other units and in some cases to outside parties.

Examples of service cost centres are engineering, workshop, research & development, quality control, quality assurance, designing, laboratory, welfare services, safety, transport, Component, Tool stores, Pollution Control, Computer Cell, dispensary, school, crèche, township, Security etc.

Answer 13. (d)

Inward transportation costs shall form the part of the cost of procurement of materials which are to be identified for proper allocation/ apportionment to the materials / products.

Outward transportation cost shall form the part of the cost of sale and shall be allocated / apportioned to the materials and goods on a suitable basis.

Explanation :

Outward transportation cost of a product from factory to depot or any location of sale shall be included in the cost of sale of the goods available for sale.

Q. 14. (a) How would you treat the forex component of imported packing material as per CAS 9?

(b) How would you treat overtime premium as per CAS 7 related to Employee Cost?

(b) How would you assign administrative overheads as per CAS 11?

(b) How would you determine the cost of utilities generated for inter company transfers as per CAS 8?

Answer 14. (a)

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 14. (b)

Overtime premium shall be assigned directly to the cost object or treated as overheads depending on the economic feasibility and specific circumstances requiring such overtime.

Answer 14. (c)

Assignment of administrative overheads to the cost objects shall be based on either of the following two principles:

- (i) *Cause and Effect* – Cause is the process or operation or activity and effect is the incurrence of cost.
- (ii) *Benefits received*– Overheads are to be apportioned to various cost objects in proportion to the benefits received by them.

The costs of shared services should be assigned to user activities on the basis of actual usage. General management costs should be assigned on rational basis.

Answer 14. (d)

Cost of Utilities generated for the inter company transfers shall comprise direct material cost, direct employee cost, direct expenses, factory overheads, distribution cost and share of administrative overheads.

Q. 15. (a) Distinguish between “Notes” and “Qualifications” in Cost Audit Report. Give suitable examples.

(b) Why is Cost Audit Report not made public? State whether a member of Parliament have access to the Cost Audit Report?

Answer 15. (a)

Section 227(2) of the Company’s Act, 1956, requires the auditor to make report to the shareholders on the accounts examined by him. When in any of the matters as required to be stated, the Auditor feels that

satisfactory compliance was not done by the company, the auditor shall state the fact of non-compliances and suitably qualify the point with reason.

The same principle also holds good for the Cost Auditor, though the report is to be submitted to the Central Government. Wherever a particular statement or basis of costing needs some explanation or clarification, the auditor shall add suitable "Notes" at appropriate places by way of explanation. For example, if a company has added a new activity, on account of which a portion of overhead charges to a product gets reduced during a year, this may be explained by way of "Notes".

On other hand if a company has deviated from the accepted Cost Accounting principles, in order to inflate costs, the auditor shall make a qualified report to the Government.

For example, if a company has spent a huge amount on evaluation of new product ideas and has charged the entire amount to the Administrative Overhead, the Cost Auditor should qualify the excess amount and the impact on each unit of Cost of Production of the products under audit. Such report will be a "qualified report".

Answer 15. (b)

According to Cost Audit Report Rules, the Cost auditor is required to submit the Cost Audit Report to the Central Government and a copy thereof to the company concerned. The shareholders and the general public have no access to the Cost audit Report unlike the Financial Audit Report. Cost Audit Report is treated as a confidential document as it contains vital information which if divulged would affect competitiveness of trade and business of the company whose information is so divulged. A Cost Audit Report contains important information such as :

- (I) A detailed note on manufacturing process of the Company.
- (II) Quantities and rates of various items of input materials, i.e the entire recipe is given.
- (III) Quantities and rates of utilities consumed.
- (IV) Average sales realization, sales promotion expenses including discount allowed.
- (V) Details regarding export market, quantity exported, F.O.B realization etc.
- (VI) Any other energy saving measure or technical improvement in process, which a company might have implemented arising out of its own research.

Such data, as a measure of business strategy should not be made available to the competitors who may take advantages and put the company to a disadvantageous position. As such cost data is a secret matter and the company secrets and management strategy contained therein should not be disclosed. There is a provision under subsection(10) of section 233-B of the Companies Act that Central Government can direct a company to make available the Cost Audit Report in full or in part to the shareholders. However this power has not been exercised so far.

It is for the same reason mentioned above that members of parliament are not allowed to access Cost Audit Report. It is the Parliament who has made the law under which Cost Audit Report is treated as confidential document other than for the Government and the company. So unless the law is changed, members, who are representatives of public cannot have access to Cost Audit Report. But Government have agreed to give all non confidential information like overall profitability, capacity utilization etc from Cost Audit Report. In view of what has been stated above, there is no specific provision in the Companies Act or Cost Audit Report Rules to make the Cost Audit Report being made available to members of Parliament.

Section II : Operational Audit

Q. 16. (a) State whether following statements are *True* or *False*. Justify your answer.

- (i) There are no fixed items of evidence to be checked by Management Auditor.
- (ii) Three-fourths of the members of the audit committee shall be independent directors.
- (iii) Position Analysis is one of the techniques used by Management Auditor for evaluation of corporate image.
- (iv) Dumping is an 'illegal' practice.
- (v) Sarbanes –Oxley Act of 2002 is a U.K federal law enacted on July 30, 2002.
- (vi) Assurance engagements involve three separate parties.
- (vii) Excise Audit 2000 was initiated from 1st April 2000.
- (viii) "Firm of Cost accountants" should have at least two partners who are practicing Cost Accountants.
- (ix) GATT and its agreement are permanent.
- (x) "Organisation Development" (OD) is a "Sensitivity Training" intervention.

(b) Fill in the blanks with appropriate word/words.

- (i) The main emphasis of Management Audit is problem _____ rather than problem _____ .
- (ii) Pareto distribution is technique used in _____ control.
- (iii) Section 292 A of the Companies Amendment Act, 2000 provides for constitution of _____ .
- (iv) SALVAGE is considered as _____ by insurer against what is owed under the policy for an insured loss.
- (v) Excisable goods must come out of _____ process.
- (vi) Margin of Dumping means the difference between _____ and _____ .
- (vii) The origin of the term 'Due Diligence' owes to _____ .
- (viii) _____ cannot be delegated.
- (ix) QRB consists of chairperson and _____ other members.
- (x) _____ is a movement protecting interest of the consumers.

Answer 16. (a)

- (i) **True.**
A Management Auditor has to rely more on his experience and acumen to identify areas of review.
- (ii) **False.**
2/3rd of the members of the audit committee shall be independent directors.
- (iii) **True.**
Position Analysis helps in determining market share, market stability, etc.
- (iv) **False.**
Dumping is an 'unfair' practice.
- (v) **False.**
This is a United States federal law enacted on July 30, 2002.
- (vi) **True.**
The parties are a public accountant in practice, a responsible party and intended users.

(vii) **False.**

Excise Audit 2000 was initiated from 1st December 1999.

(viii) **False.**

“Firm of Cost accountants” means sole proprietorship concern, the sole proprietor of which is a Cost Accountant in Practice or a firm, wherein all partners are Cost Accountants and such firm is approved by the Council.

(ix) **False.**

GATT was ad hoc and provisional.

(x) **True.**

The most commonly used Organizational Development intervention is sensitivity training. It is called laboratory training as it is conducted by creating an experimental laboratory situation in which employees are brought together, in groups, to interact in an unstructured environment. The members are encouraged to interact with new members and new individual behaviors.

Answer 16. (b)

- (i) identification, solving
- (ii) inventory
- (iii) Audit Committees
- (iv) credit
- (v) production
- (vi) normal value, export price of goods
- (vii) US Securities Act, 1933
- (viii) Responsibility
- (ix) four
- (x) Consumerism

Q. 17. Discuss the following :

(a) A Management Audit team should be multidimensional.

(b) Management frauds

Answer 17. (a)

Management Audit is a service function with the object of assisting management in achieving the most efficient administration. Management audit involves multidisciplinary and multidimensional approach and requires systematic and dispassionate review of analysis and appraisal of overall performance. It takes into account the techno-economic study of the Industry. As a management auditor is concerned with all aspects of business and the organization, ranging from manufacture to marketing and finance, the management audit team should be multidisciplinary to make multidimensional approach to audit function.

Answer 17. (b)

Fraud is an intentional misrepresentation of facts. In general, it is seen that top executives like Managing Directors, Directors, General Managers and other such executives occupying the positions in an organization are found to commit management frauds. These frauds are the deception practiced by these managers so as to show their performance better than what they actually are.

The frauds may be committed in cash or in kind for personal benefit of the managers. Such frauds may take the form of misappropriation of assets and manipulation of records. Because of their fiduciary

position, the managers have greater control over preparation of accounting and financial statements and better opportunities to defraud the company and others. Prevention of frauds is the duty of management. But when top management itself is perpetuating frauds, it becomes very difficult for anyone else to detect it. The following measures may be adopted for control and prevention of management frauds :

- (i) Introduction of adequate internal control system.
- (ii) Conducting system audit to improve systems and procedures.
- (iii) Sound personnel policies – reviewed and if necessary, revised periodically.
- (iv) Tightening supervision at all levels.
- (v) Significant variations from budgets or standards should be checked in detail.

Q. 18. (a) You have been appointed as an internal auditor for M/s KBC Ltd which is a large manufacturing concern. You are asked to verify whether there are adequate records for identification and value of Plant and Machinery, tools and dies and whether any of these items have become obsolescent and not in use. Draft a suitable audit programme for the above.

(b) Write short note on - Cut-off Procedures

Answer 18. (a)

The Internal Audit Programme in connection with Plant and Machinery and Tools and dies may be on the following lines:

- (i) *Internal Control Aspects* : The following may be incorporated in the audit programme to check the internal control aspects :
 - (A) Maintaining separate register for hired assets, leased asset and jointly owned assets.
 - (B) Maintaining register of fixed asset and reconciling to physical inspection of fixed asset and to nominal ledger.
 - (C) All movements of assets are accurately recorded.
 - (D) Authorization be obtained for –
 - (i) a declaring a fixed asset scrapped.
 - (ii) selling a fixed asset.
 - (E) Check whether additions to fixed asset register are verified and checked by authorised person.
 - (F) Proper recording of all additions and disposal.
 - (G) Examining procedure for the purchase of new fixed assets, including written authority, work order, voucher and other relevant evidence.
 - (H) Regular review of adequate security arrangements.
 - (I) Periodic inspection of assets is done or not.
 - (J) Regular review of insurance cover requirements over fixed assets.
- (ii) *Assets Register* : To review the registers and records of plant, machinery, etc. showing clearly the date of purchase of assets, cost price, location, depreciation charged, etc.
- (iii) *Cost Report and Journal Register* : To review the cost relating to each plant and machinery and to verify items which have been capitalised.
- (iv) *Code Register* : To see that each item of plant and machinery has been given a distinct code number to facilitate identification and verify the maintenance of Code Register.
- (v) *Physical Verification* : To see physical verification has been conducted at frequent intervals.
- (vi) *Movement Register* : To verify (a) whether a Movement Register for movable equipments and (b) log books in case of vehicles, etc. are being maintained properly.

- (vii) *Assets Disposal Register* : To review whether assets have been disposed off after proper technical and financial advice and sales/disposal/retirement, etc. of these assets are governed by authorisation, sales memos or other appropriate documents.
- (viii) *Spare Parts Register* : To examine the maintenance of a separate register of tools, spare parts for each plant and machinery.
- (ix) *Review of Maintenance* : To scrutinise the programme for an actual periodical servicing and overhauling of machines and to examine the extent of utilisation of maintenance department services.
- (x) *Review of Obsolescence* : To scrutinise whether expert's opinion have been obtained from time to time to ensure purchase of technically most useful efficient and advanced machinery after a thorough study.
- (xi) *Review of R&D* : To review R&D activity and ascertain the extent of its relevance to the operations of the organisation, maintenance of machinery, efficiency and prevention of early obsolescence.

Answer 18. (b)

Cut-off procedures mean procedures employed to ensure the separation of transactions at the end of one year from those in the commencement of the next year. Usually, the problem of overlapping is found in inventory accounting since quite often goods are sold but passed on to the buyer only after the year is over or goods are bought but received only after the close of the year. This situation may create considerable problem for the proper stock taking of inventory. Therefore, the principal areas of application of cut-off procedures involve sales, purchases and stock. The auditor should satisfy himself by examination and test check that these procedures adequately ensure that :

- (i) Goods purchased for which property has passed to title client have in fact been included in inventories and that the liability if any, has been provided for.
- (ii) Goods sold have been excluded from the inventories and credit sales been taken for sales.

The auditor may examine a sample of documents evidencing the movement of stocks into and out of stores, including documents pertaining to period shortly before and shortly after the cut-off date, and check whether the stocks represented by those documents were included or excluded, as appropriate, during the stock-taking.

Q. 19. (a) Briefly discuss how compliance procedures can be used in evaluation of internal controls.**(b) Draft an internal control questionnaire for 'Accounts Payable'?****Answer 19. (a)**

The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions there from on which to base his opinion on the financial information. According to it, compliance procedures are tests designed to obtain reasonable assurance that those internal controls on which audit reliance is to be placed are in effect. Obtaining audit evidence from compliance procedures is intended to reasonably assure the auditor in respect of the following assertions :

- Existence - that the internal control exists.
- Effectiveness - that the internal control is operating effectively.
- Continuity - that the internal control has so operated throughout the period of intended reliance.

The auditor formulating his opinion on financial information needs reasonable assurance that transactions are properly authorised and recorded in the accounting records and that the transactions have not been omitted. Internal controls, even if fairly simple, may contribute to the reasonable assurance

the auditor seeks. The auditors' objective in studying and evaluating internal controls is to establish the reliance he can place thereon in determining the nature, timing and extent of his substantive auditing procedures.

Compliance procedures are tests designed to obtain reasonable assurance that those internal controls on which audit reliance is to be placed are in place and are also effective. Compliance procedures enable the auditor to determine the existence, effectiveness and continuous operation of the internal control system. These procedures include tests requiring inspection of documents supporting transactions to gain evidence that controls have operated properly. For example, the auditor may see that the documents have been properly authorised. The auditor may also make enquiries about the observation of controls, for example, determining who actually performs each function not merely who is supposed to perform it. Compliance procedures are conducted by the auditor to gain evidence that those internal controls on which he intends to rely operates generally as identified by him and they function effectively throughout the period of intended reliance. The concept of effective operation recognises that some deviations from prescribed controls may have occurred.

Based on the results of his compliance procedures, the auditor evaluates whether the internal controls are adequate for his purpose. If based on the results of the compliance procedures, the auditor concludes that it is not appropriate to rely on a particular internal control to the degree previously contemplated, he should ascertain whether there is another control which would satisfy his purpose and on which he might rely (after applying appropriate compliance procedures). Alternatively, he may modify the nature, timing or the extent of his substantive audit procedures.

Answer 19. (b)

The internal control questionnaire for 'Accounts Payable' may be drafted as follows :

Questions	Yes	No	N/A	Remarks
1. Are all invoices received directly by the person who processes invoices for payment?				
2. Are payments made only on the basis of original invoices and are duplicate copies of invoices clearly marked immediately upon receipt to prevent duplicate payment?				
3. Does the review of invoices include				
(i) Check of terms, prices, and quantities on invoices against purchase orders?				
(ii) Check of items and quantities with those indicated on receiving reports obtained directly from the receiving department?				
(iii) Mathematical check of footings, extensions, and discounts?				
(iv) A final approval for payment?				
(v) Indicating on the invoice that the above checks and approvals were made?				
4. Do controls exist ensuring accurate account distribution of all entries resulting from invoice processing?				
5. Do controls exist for processing invoices that do not involve materials or supplies (e.g., fees, rentals, power and light, taxes, travel, etc.)?				
6. Are written contracts used for all professional and artistic services?				

<p>7. Do procedures exist to review billings for contractors for compliance with the contract prior to making payments?</p> <p>8. Are returned purchases controlled in a manner that ensures that the refund or credit will be received?</p> <p>9. Do procedures exist to insure that the leasing of equipment does not exceed the cost of purchasing and maintaining similar equipment?</p> <p>10. Are vendor credit memos resolved promptly by cash refund or taken against subsequent purchases?</p> <p>11. Is the encumbrance record periodically agreed to open purchase orders and commitments?</p> <p>12. Is the encumbrance cancelled when the expenditure is recorded?</p> <p>13. Are adequate records maintained of unmatched purchase orders and receiving reports and not vouchered vendors' invoices and are these periodically reviewed and investigated?</p> <p>14. With respect to partial shipment from vendors :</p> <p style="padding-left: 20px;">(i) Is a control maintained clearly indicating on the P.O. information as to the payment to avoid duplicate payment upon completion of the order?</p> <p style="padding-left: 20px;">(ii) Are there any other procedures in effect to prevent duplicate payments on partial shipments by vendors?</p> <p>15. Is an accounts payable trial balance taken and balanced to the general ledger control at least monthly?</p> <p>16. Are monthly statements from vendors regularly reconciled to open vouchers or accounts payable ledgers?</p> <p>17. For accounts payable balances :</p> <p style="padding-left: 20px;">(i) Are adjustments of recorded amounts required to be supported by proper approval?</p> <p style="padding-left: 20px;">(ii) Are debit balances properly reviewed and followed up?</p> <p>18. Are there procedures in effect to ensure proper expenditure cutoff.</p> <p>19. Are expenditures of funds in excess of budgeted amounts approved by the budgeting office?</p> <p>20. Are the duties of data authorization, data entry, verification of data, data correction, and receipt and distribution of warrants/ checks adequately segregated?</p> <p>21. Are checks/warrants verified to the check/warrant register and supporting documentation prior to disbursement by someone independent of preparation?</p> <p>22. Does internal control appear adequate for the accounts payable system overall?</p>				
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Q. 20. ABC Bank, a nationalised bank received an application from XYZ Ltd, an export company seeking sanction of a term loan to expand the existing tinned cooked food processing plant. In this connection, the General Manager, who is in charge of Advances, approaches you to conduct a thorough investigation of this limited company and submit a confidential report based on which he will decide whether to sanction this loan or not.

List out the points you will cover in your investigation before submitting your report to the General Manager.

Answer 20.

A bank is primarily interested in knowing the purpose for which a loan is required, the sources from which it would be repaid and the security that would be available to it, if the borrower fails to pay back the loan. On these considerations, the investigating accountant, in the course of his enquiry, should attempt to collect information on the under mentioned points :

- (i) Purpose for which the loan is required and the manner in which the borrower proposed to invest the amount of the loan.
- (ii) Schedule of repayment of loan submitted by the borrower, particularly, the assumptions made therein as regards amounts of profits that will be earned in cash and the amount of cash that would be available for the repayment of loan to confirm that they are reasonable and valid in the circumstances of the case.
- (iii) Financial standing and reputation for business integrity enjoyed by the directors and officers of the company.
- (iv) Authorisation under Memorandum or the Articles of Association to borrow money for the purpose for which the loan will be used.
- (v) History of growth and development of the company and its performance during the past five years.

To investigate the profitability of the business for judging the accuracy of the schedule of repayment furnished by the borrower, as well as the value of the security in the form of assets of the business already possessed and those which will be created out of the loan, the investigating accountant would be concentrating on the following points:

- (a) Preparation of a condensed income statement from the Profit and Loss Accounts for the previous five years, showing separately therein various items of income and expenses, the amounts of gross and net profits earned and taxes paid annually during each of the five years. The amount of maintainable profits determined on the basis of foregoing statement should be increased by the amount by which these would increase on the investment of borrowed funds.
- (b) Computation of under-mentioned ratios separately and then include them in the statement to show the trend as well as changes that have taken place in the financial position of the company :
 - (i) Sales to Average Stocks held.
 - (ii) Sales to Fixed Assets.
 - (iii) Equity to Fixed Assets.
 - (iv) Current Assets to Current Liabilities.
 - (v) Quick Assets (the current assets that are readily realisable) to Quick Liabilities.
 - (vi) Equity to Long Term Loans.
 - (vii) Sales to Book Debts.
 - (viii) Return on Capital Employed.
- (c) Break-up of annual sales product-wise to show their trend.

- (d) Schedule of assets and liabilities of the borrower including the particulars stated below :
- (i) *Fixed assets* : A full description of each item, its gross value, the rate at which depreciation has been charged and the total depreciation written off. In case the rate at which depreciation has been adjusted is inadequate, the fact should be stated. In case any asset is encumbered, the amount of the charge and its nature should be disclosed. In case an asset has been revalued recently, the amount by which the value of the asset has been decreased or increased on revaluation should be stated along with the date of revaluation. If considered necessary, he may also comment on the revaluation and its basis.
 - (ii) *Stocks* : The value of different types of stocks held (raw materials, work-in-progress and finished goods) and the basis on which these have been valued. Details as regards the nature and composition of finished goods should be disclosed. Slow-moving or obsolete items should be separately stated along with the amounts of allowances, if any, made in their valuation. For assessing redundancy, the changes that have occurred in important items of stock subsequent to the date of the Balance Sheet, either due to conversion into finished goods or sale, should be considered. If any stock has been pledged as a security for a loan the amount of loan should be disclosed.
 - (iii) *Sundry debtors, including bills receivable* : Their composition should be disclosed to indicate the nature of different types of debts that are outstanding for recovery; also whether the debts were being collected within the period of credit as well as the fact whether any debts are considered bad or doubtful and the provision if any, that has been made against them. Further, the total amount outstanding at the close of the period should be segregated as time-period wise.
 - (iv) *Investments* : The schedule of investments should be prepared. It should disclose the - date of purchase, cost and the nominal and market value of each investment. If any investment is pledged as security for a loan, full particulars of the loan should be given.
 - (v) *Secured Loans* : Debentures and other loans should be included together in a separate schedule. Against the debentures and each secured loan, the amounts outstanding for payments along with due dates of payment should be shown. In case any debentures have been issued as a collateral security, the fact should be stated. Particulars of assets pledged or those on which a charge has been created for re-payment of a liability should be disclosed.
 - (vi) *Provision of Taxation* : The previous years up to which taxes have been assessed should be ascertained. If provision for taxes not assessed appears to be inadequate, the fact should be stated along with the extent of the shortfall.
 - (vii) *Other Liabilities* : It should be stated whether all the liabilities, actual and contingent, are correctly disclosed. Also, an analysis according to ages of trade creditors should be given to show that the company has been meeting its obligations in time and has not been depending on trade credit for its working capital requirements.
 - (viii) *Insurance* : A schedule of insurance policies giving details of risks covered, the date of payment of last premiums and their value should be attached as an annexure to the statements of assets, together with a report as to whether or not the insurance-cover appears to be adequate, having regard to the value of assets.
 - (ix) *Contingent Liabilities* : By making direct enquiries from the borrower company, from members of its staff, perusal of the files of parties to whom any loan has been advanced those of machinery suppliers and the legal adviser, for example, the investigating accountant should ascertain particulars of any contingent liabilities which have not been disclosed. In case, there are any, these should be included in a schedule and attached to the report.

- (x) The impact on economic position of the company by economic, political and social changes that are likely to take place during the period of loan.

Q. 21. Explain whether the following amounts to professional misconduct by a Cost Accountant :

- (a) A Cost Accountant practicing in India enters into partnership with a CMA, U.S.A.
- (b) F, a partner of a firm of Cost Accountants during a T.V. interview handed over a bio-data of his firm to the chairperson. Such bio-data detailed the standing of the international firm with which the firm was associated. It also detailed the achievements of the concerned partner and his recognition as an expert in the field of taxation in the country. The chairperson read out the said bio-data during the interview.
- (c) W, a Cost Accountant wrote several letters to Government Department, pointing out seniority of his firm, sending his life sketch and stating that he had a glorious record of service to the country as well as to the organization of accountancy profession with a view to get the cost audit work.
- (d) Mr. X, a Cost Accountant certified the cost statements of a company in which his wife is a Director holding substantial interest.

Answer 21. (a)

As per MOU with IMA, USA a member of The Institute of Cost Accountants of India can get enrolled as a member of IMA USA and vice versa. However, an IMA member enrolling as a member of The Institute of Cost Accountants of India will not be allowed to hold a certificate of practice to undertake any statutory work in India. A Cost Accountant practising in India and entering into partnership with a CMA, U.S.A. amounts to professional misconduct.

Answer 21. (b)

Clause 7 of Part I of the First Schedule to the Cost and Works Accountants Act, 1959 prohibits solicitation of client or professional work either directly or indirectly by circular, advertisement personal communication or interview or by any other means since it shall constitute professional misconduct. The bio-data was handed over to the chairperson during the T.V. interview by the Cost Accountant which included details about the firm and the achievements of the partner as an expert in the field of taxation. The chairperson simply read out the same in detail about association with the international firm as also the achievements of the partner and his recognition as an expert in the field of taxation. Such an act would definitely lead to the promotion of the firms' name and publicity thereof as well as of the partner and as such the handing over of bio-data cannot be approved. The partner would be held guilty of professional misconduct under Clause (7) of Part I of the First Schedule to the Cost and Works Accountants Act, 1959.

Answer 21. (c)

'W' a Cost Accountant, wrote several letters to Government Department pointing out the seniority of his firm and sending his life sketch and stating that he had rendered glorious service to the country and to the accountancy profession with a view to getting the audit work. Clause (6) of Part I of First Schedule to the Cost and Works Accountants Act, 1949 prohibits a member not to solicit professional work by means of advertisement, circular, personal communication or interview or by any other means. Since these letters were clearly in the nature of advertising professional attainments, "W" was guilty of professional misconduct under clause (6) of Part I of First Schedule to the Cost and Works Accountants Act, 1959.

Answer 21. (d)

Clause (4) of Part I 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 in which his firm or

partner in his firm or his relative has substantial interest, he is committing professional misconduct unless he discloses the interest also in his report. Such disclosure is intended to assure the public as regard the faith and confidence that could be reposed in the independent opinion expressed by the auditor. In the given case Mr. X, Cost Accountant, has certified the cost statements of a company in which his wife is a director with substantial interest. Hence this amounts to professional misconduct which attracts clause (4) of Part-I of Second Schedule to the Cost and Works Accountants Act, 1959.

Q. 22. (a) What is CFC? What type of work can be handled by CFC with regard to Central Excise & Service Tax under ACES Scheme?

(b) What do you understand by “Corporate Services Audit”? Describe the areas of Corporate Services Audit, the scrutiny thereof and the evaluation criteria used in such audit.

Answer 22. (a)

CFC stands for Certified Facilitation Centre under ACES project of CBEC and is an e-facility, which may be set-up and operated by a Cost Accountant in whole time practice to whom a certificate to act as CFC has been issued by The Institute of Cost Accountants of India after approval by CBEC under the ACES project. Under this scheme the assesseees of Central Excise and Service Tax can avail of this facility to file their returns and other documents electronically along with associated facilitation on payment of specified fees to Certified Facilitation Centre.

In respect of Central Excise, the works which can be handled by CFC are – Registration, Returns, Refunds & Rebate, Claims & Intimations, Provisional Assessments, Exports, Dispute Resolution and Audit.

Similarly, in respect of Service Tax, the works which can be handled by CFC are – Registration, Returns, Refunds, ST3A, Dispute Resolution and Audit.

Currently, under the ACES Scheme the following Returns can be filed by Cost Accountants in practice :

- Excel Utilities for Central Excise Returns - ER1, ER2, ER3, ER4, ER5, ER6 and Dealer's Return
- XML Scheme for Central Excise Returns - ER1, ER2 and Dealer's Return
- Excel Utility for Service Tax Return (ST3)

Further, the assesseees can carry out many on-line transactions such as online registration, amendment to the registration form, filing of various claims, intimations, and permissions, refund claims, request for provisional assessment and export related documents. They can also file replies to show cause notices and appeals to Commissioner (Appeals).

Answer 22. (b)

The term “Corporate Services” is a generic term, which implies service oriented obligations of a corporate body to different interested ‘Public’ such as consumers, shareholders, community, fellow-businessmen, government etc. It includes the social responsiveness of a business enterprise.

Corporate Services Audit is the audit of social behavior of the company to assess the extent to which the company had met the expectations of the customers, employees, shareholders, suppliers and the community.

The scope of the Corporate Services Audit extends to the critical examination of the different aspects of services and the extent to which the corporate body has rendered satisfactory services. It also includes the evaluation of the degrees of responsiveness and awareness on the part of such enterprise. The performance of the management towards customers, employees, shareholders, suppliers, the community and government is studied separately and properly evaluated by management auditor.

The areas of Corporate Services Audit and the scrutiny and evaluation criteria can be categorized as follows :

Consumers : Quality of goods in right quantity, right price, right place and right time.

Employees : Pay, Safety, Welfare and Industrial Relations etc.

Shareholders : Safety of investment, satisfactory return and capital appreciation.

Community : Social cost and social benefit, public relation

Fellow-businessmen : Business ethics and fair trade dealings.

State : Compliance with various legislations, fair trade practices, payment of taxes etc.

The concept of Corporate Services Audit is that its appraisal system should consider the level of contribution a business entity makes to society and its environment towards raising the quality of life through better product quality and services rather than profit maximization. The Corporate Services Audit thus attempt to distinguish between the end and means of business and provides a new dimension to the concept of audit approach. In Corporate Services Audit, the auditor checks the company's response to different social needs.

Q. 23. (a) Give an "Audit programme" as an Internal Auditor of Wage Audit.

(b) What is productivity audit? Describe the steps involved and the measures used in this audit.

Answer 23. (a)

Audit programme as an internal Auditor of Wage Audit :

(I) Information about Auditee and audit work :

- (i) Name of the Auditee.
- (ii) Address/Location.
- (iii) Period to be covered.
- (iv) Estimated time(days) required.
- (v) Audit Team members consists of Partner/Qualified/Semi-qualified etc.
- (vi) Queries of the Auditor to be settled by the representative of the concern.
- (vii) Report to be submitted to the representative of the company.

(II) Study of various records :

- (i) Wage related policy manuals.
- (ii) Grade Structure.
- (iii) Incentive Rules.
- (iv) Overtime Rule.
- (v) Bonus Scheme.
- (vi) Various Statutory deduction schemes as for example ESI, PF, EPF etc.

(III) Verification of :

- (i) Payroll package is properly updated with employee's details and it is properly functioning.
- (ii) Take out the list of employees for the purpose of verification that no entry is Bogus i.e Ghost Worker.
- (iii) Ensure that all wage payments are made through banks.
- (iv) Where payment is made in cash, whether it is done in presence of responsible officer.
- (v) Cross verify wage with some employees, so that there will be assurance with system.
- (vi) Checking of Daily Attendance Sheet, Absenteeism Statement, Manpower Planning and Deployment.

- (vii) Checking of Employee Signature at the time of payment in case of cash payment and Attendance Register.
- (vii) Checking of Appointment/Retirement records of Employees.

Answer 23. (b)

Productivity audit is the process of monitoring and evaluating organizational practices to determine whether functions, programmes, and organization itself are utilizing resources effectively and efficiently so as to accomplish objectives.

It is measured in terms of outputs and inputs in relation to the three major factors of production i.e. material, labour and capital. The measurement used in relationship between outputs and inputs measured in physical and/or financial terms.

Productivity audit concentrates on areas such as

- (i) productivity actions
- (ii) resource availability
- (iii) performance standards
- (iv) benefit allocation
- (v) productivity policies
- (vi) equipment usage
- (vii) accountability reporting
- (viii) resource allocation.

The measures of productivity for three factors of production :

Material productivity : (i) Obtaining higher output for same input.
(ii) Obtaining same output with lower input

Labour productivity : (i) Labour hour per unit of product.
(ii) Output per man hour.
(iii) Added value per capita or per rupee of labour cost.

Capital productivity : (i) Physical output per rupee of investment.
(ii) Value of production per rupee of investment.
(iii) Value added per rupee of investment.

The audit is done by

- (i) Ratio analysis
 - Return on capital employed
 - Return on sales
- (ii) Capacity utilization of plant, equipments and facilities against available capacity
- (iii) Material consumption against bench marks.
- (iv) Productivity analysis of man hours in time and cost.

Productivity audit consists of following steps :

- (i) Setting of standards for different factors of production.
- (ii) Choosing yardsticks for measurement of each of the factors.
- (iii) Comparing actual performance with standards and identifying variances.
- (iv) Making recommendations for control action.

Q. 24. (a) You have been appointed to carry out Management-cum-Operational Audit of a PQR Ltd. State whether the use of quantitative ratios is more effective than the use of financial ratios to gain real insight into the financial and cost statements.

(b) Write short note on – Human Resource Accounting.

Answer 24. (a)

The auditor employs a number of techniques to assess the reliability and validity of financial and cost statements. Ratio analysis is one of such techniques and is a valuable tool for overall assessment. Ratio analysis constitutes a substantive auditing procedure designed to obtain evidence as to the completeness, accuracy and validity of the data produced by the accounting system. Such an assessment is necessary in organisations having large volume of transactions and in those organisations following mechanised accounting system where it is not possible to check each and every transaction. It has the merit of bringing to focus the abnormal deviations and unexpected variations which the normal routine checking in auditing may fail to reveal. Infact, the underlying problems and distortions are brought to light by this procedure.

Quantitative ratios and reconciliations can be used more effectively than the financial ratios by an auditor. More particularly, the objective of management-cum-operational audit is not only to verify compliance with the control but to suggest measures to improve operational environment and thus increase overall productivity. Financial ratios keep changing with the variations in the price level. In a dynamic economy, price levels seldom remain constant and hence comparison of financial ratios over the years becomes vitiated. Quantitative ratios and reconciliations remain unaffected by changes in price. They reflect certain basic relationships and change only if there is a change in the method of operation, technology, degree of automation, product mix, etc. A comparison of quantitative ratios over the years can reveal pertinent and leading indications of the real state of affairs. An auditor can gain a real insight into financial statements through the underlying quantitative data. The various quantitative ratios which may be calculated are input-output ratio for a manufacturing concern, occupancy ratio for hotels, etc. The overall reconciliation statement in case of stocks, membership fees of club, payroll with number of employees etc. will be very useful and effective. To illustrate, in a manufacturing industry, normally, standard input-output ratios available enable the auditor to compare quantity of input with reference to quantity of output and normal production losses involved therein. In fact, input-output ratios shall be of great significance in measuring efficient use of resources not only within the organisation but also to measure the performance of the entity against industry standards.

The nature of quantitative ratios and reconciliations that an auditor can work out in a particular audit would depend upon the actual circumstances of the case. However, the auditor must keep a few general considerations in mind while using quantitative data. Firstly, he should analyse and use such data mainly as an evidence to support the figures in the statements under audit. The quantitative wastages and losses may be so high or so low that the genuineness of the production, sales or stock figures may become doubtful. Secondly, the auditor should try to correlate vital relationships between physical quantities. In this regard the auditor should establish the cause and effect relationship between activities. In many cases the sequence of activities and their predecessor-successor relationships may be used to work out activity ratios. Thirdly, the auditor may attempt to link a physical quantity with its corresponding monetary figure through an estimated average rate. Thus, the number of members of different categories in a club may be multiplied by the average rate of membership fee for each category of membership. This would be a good check on the figure of the total membership fees. Though working out quantitative ratios involve greater strain on the auditor, it is more rewarding.

Answer 24. (b)

Human resource is perhaps the most valuable asset in an undertaking. Flamholtz defines human resource as “accounting for people as an organizational resource. It involves measuring the costs incurred by business firm and other organizations to recruit, select, hire, train and develop human assets. It also

includes measuring the economic value of people to organisations". This definition gives two methods of valuing human resources, i.e., cost and the economic value. A company may value its human resources on the cost basis, i.e., at the costs incurred by it in procuring and developing these assets. Another method is to work out the replacement values of persons, representing the economic value. According to Flamholtz, an individual possesses value for an organisation because he is capable of rendering future services. Theoretically, therefore, his value to an organisation is equal to the present worth of his expected future services. Thus, an individual's value to an organisation can be defined as the present worth of the set of future services that the person is expected to provide during the period he is anticipated to remain in the organisation. In this connection, putting a monetary value on human resources presents a lot of practical problems particularly from the auditor's view point because of element of subjectivity is inherent in the process of such valuation.

Q. 25. Discuss the role of CMAs in the following areas :

- (a) TRAI
- (b) MCA-21 scheme
- (c) Government Department.

Answer 25. (a)

Telecom Regulatory Authority of India (TRAI)

- (i) Right to Legal Representation before Appellate Tribunal as per Section 17 of TRAI Act, 1997
- (ii) Reporting and Audit for System on Accounting Separation- Certification Work
- (iii) Audit for Metering and Billing Accuracy- authorised to conduct audit

Answer 25. (b)

MCA-21 scheme

Ministry of Corporate Affairs, Government of India have authorised Cost Accountants in practice to act as Certifying Filing Centres on their behalf for the purpose of certification of various type of e-forms and their filing with Registrar of Companies periodically as per the provisions of Indian Companies Act, 1956 and Limited Liability Partnership (LLP) Firms.

Answer 25. (c)

Government Department

Realising the importance of the profession of the Cost and Management Accountancy in the economic development of the nation, the Central Government has constituted an all-India cadre known as Indian Cost Accounts Service (ICoAS) at par with other Class-I services such as IAS, IFS etc. to advise the government in cost pricing and in framing the appropriate fiscal and tax policies.

Q. 26. Write short note on :

- (a) Valuation Audit and Cenvat Audit.
- (b) Constitution and Functions of Audit Committee under Section 292A of the Companies Act, 1956.
- (c) Salvage in relation to insurance claim.

Answer 26. (a)

Valuation Audit and Cenvat Audit :

Valuation is one of the most vital and critical aspects of assessment of excise duty payable. In order to ensure that duty is being paid correct 'Assessable Value', a provision has been made to order a 'Special Audit' in some specified cases vide section 14A of CEA. The audit can be ordered with prior approval of Chief Commissioner of Central Excise.

Valuation Audit under section 14A can be ordered at any stage of enquiry, investigation or any proceedings before Assistant/Deputy Commissioner regarding assessable value of the goods manufactured by assessee, if the Assistant/Deputy Commissioner is of the opinion that the value has not been correctly declared by a manufacturer or any person. It may be noted that under rule 173C(3), 'enquiry' in respect of 'value' can be made as soon as Invoice is raised or 'Declaration regarding Assessable Value' is filed with Assistant/Deputy Commissioner. The special audit for valuation can be ordered by Dy./Asst. Commissioner with prior approval of Chief Commissioner.

U/s 14 AA of CEA, special audit of Cenvat credit availed or utilized can be ordered by Commissioner of Central Excise. Such audit can be ordered if the Commissioner of CE has reasons to believe that

- (i) Cenvat credit availed or utilized is not within the normal limits, having regard to nature of final products and type of inputs.
- (ii) Cenvat credit has been availed or utilized by reason of fraud, collusion or any willful misstatement or suppression facts. Such audit can be done by practicing 'Cost Accountant', to be appointed by Commissioner of CE. Expenses of and incidental to such audit, including the remuneration payable to the cost accountant shall be paid by Central Government (i.e. excise department).

Answer 26. (b)

Section 292A of the Companies Act, 1956 requires that every public company having not less than Rs. 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 necessary.
- (iii) Its recommendations on all financial matters including audit report shall be binding on the board.
- (iv) 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.
- (v) To advise and check the compliance of the organisation for policy and regulation aspects.

Answer 26. (c)

Salvage value is the estimated value of an asset at the end of its useful life. In relation to insurance claim Salvage is the residual value of a damaged item. Salvage is a very critical issue under any insurance claim. Every damaged item has some *salvage* depending on the item, exact usability, market value, time and place of loss and options available of new item. The salvage is considered as 'credit' by the insurer against what is owed under the policy for an insured loss. The professional salvagers who are expert in this field can clean, repair and put back the damaged item in operating condition.

- Q. 27. (a) List the points to be considered while conducting environment audit of an industrial unit.**
(b) Discuss the 'scope' of concurrent audit of Banks.

Answer 27. (a)

Main areas to be covered in the case of environment audit of an industrial unit :

- (i) Layout and design of the factory to provide for the installation pollution control devices with provision for upgradation of pollution control measures to meet regulatory authorities' requirements. Areas of deficiency to be included in the report.
- (ii) 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.
- (iii) 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.
- (iv) Availability of adequate trained staff and safety amenities with provision for constant upgradation to be verified.
- (v) Availability of adequate health care provisions and medical facilities for the workers to be looked into.
- (vi) Availability of proper system to eliminate industrial unhygienic state.
- (vii) Availability of adequate safeguard against occupational health hazards depending upon the nature of industry to be verified.
- (viii) Existence of adequate information system and reporting of compliance of statutory legal provisions to the board at regular intervals to be verified.
- (ix) Compliance of regularly mechanism by way of updating the existing environment system with the latest changes in the regulations to be looked into.
- (x) 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.

Answer 27. (b)

Scope of concurrent audit of banks :

The following are the areas to be covered :

- (i) Daily cash transactions with reference to abnormal receipts and payments. This will include currency chest transactions, major expenses met by cash, high value receipts and disbursements.
- (ii) Purchase and sale of shares securities etc. Physical verification of investments and rates at which they are entered into.
- (iii) Verification of procedure and documentation to open new current, savings, term deposit accounts, etc. Unusual operations noticed have to be thoroughly examined.
- (iv) Verification of advances, overdrafts, temporary OD, Cash credit accounts, term loans, bills purchase, letters of credit etc. Procedure for sanction and documentation to be verified. Any deviation noticed to be examined in great detail.
- (v) Foreign exchange transactions to be verified with reference to RBI guidelines.
- (vi) Verification of balancing of all ledgers and registers, inter branch reconciliation calculation and verification of interest, discount, commission etc.
- (vii) Revenue leakage to be detected.
- (viii) Special efforts to be made in all fraud prone areas. The attempt should be to ensure that all effective measures are taken to prevent frauds.
- (ix) Verification of high value transactions.

- (x) Procedure for safe custody of security forms with the branch.
- (xi) Whether all procedures for tax deduction at source are followed and the tax so deducted are deposited into Government Account within the time fixed.
- (xii) Verification of returns, statements, calculation of capital adequacy ratio and compliance with requirements of government business.
- (xiii) Study of RBI and Internal Inspection reports statutory auditors report and compliance thereto.
- (xiv) Whether the customers' complaints are dealt with promptly.

Q. 28. Write short notes on :

- (a) Main functions of WTO.**
- (b) The function of IAASB.**

Answer 28. (a)

The World Trade Organisation is the main organ of implementation of the Multilateral Trade Agreements (MTAs). After World Bank and IMF, this is the third biggest International Organisation in Finance and Trade matters. The main functions of WTO are as follows :

- (i) Facilitate the management of the MTAs and the Plurilateral Trade Agreements for fulfillment of their obligations.
- (ii) All Multilateral Trade Relations concerning the above agreements will be negotiated by the Members in this forum.
- (iii) WTO will also facilitate implementation of the results of the negotiations as decided by the Ministerial Conference.
- (iv) The WTO shall administer the Understanding on Rules and Procedures Governing the Settlement of Disputes, forming part of the Agreements (MTAs and PTAs.)
- (v) The WTO is responsible for administration of the Trade Policy review Mechanism (TPRM) forming part of the Agreement.
- (vi) WTO is also the organ for establishing co-ordination with other Wings of the UNO such as the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD) and its affiliated agencies.

Answer 28. (b)

International Auditing and Assurance Standards Board (IAASB) is an independent standard-setting body within the International Federation of Accountants (IFAC). The IAASB develops International Standards on Auditing and International Standards on Review Engagements, which deal with the audit and review of financial information; and International Standards on Assurance Engagements which deal with assurance engagements other than audit and review of financial information. The IAASB also develops related practice statements. These standards and statements serve as guidelines for high quality of auditing and assurance statements world wide. In addition the ISSAB develops quality control standards for firms and engagement teams in practice areas of audit, assurance and related services.

Q. 29. Mr. F who proposes to buy the proprietary business of Mr. Q, engages you as investigating accountant. Specify the areas which you will cover in your investigation.

Answer 29.

The first and foremost important aspect in any business investigation is to have an overall picture of the position of the business which is being investigated before the details are gone into. Further, it is important to know whether the business is engaged in the manufacture of one or two important lines of products, is

principally processing materials or is concerned only with the sale of a single product. Also, whether it is a business which depends for its success on imported raw materials or supply of parts and components from ancillary businesses or uses indigenous materials and parts which are manufactured locally. If the business is labour - intensive, its future profitability would be dependent on availability of skilled labour and relations of the management with the trade unions. Labour relations thus can affect the future profitability of the business. The method of distribution of products, either through wholesalers or retailers also must be examined. For studying the economic and financial position of the business, the following should be considered :

- (i) The adequacy or otherwise of fixed and working capital. Are these sufficient for -the growth of the business?
- (ii) What will be the trend of the sales and profits in the future? The success of a business in the future would depend on the position enjoyed by it in the past in relation to its competitors. A business may be successful because it enjoys a monopoly. In such a case, the possibility of emergence of competition must be examined. This may be ascertained on the basis of the trend in market share of the product and the licensing policy followed by the government. Establishing the trend of sales, product-wise and area-wise will ordinarily help in drawing a conclusion on whether the trend will be maintained in the future.
- (iii) Whether the profit which the business could be expected to maintain in the future would yield an adequate return on the capital employed?

From the accountant's view point, the following specific areas need to be looked into :

Profit and Loss Account : To study the Profit and Loss Account of a concern and consider each item, included therein, in relation to the corresponding items in the Profit and Loss Account of the previous years. It is therefore, necessary that a summary, in a columnar form, should be prepared of the balances included in the Profit and Loss Accounts of the business for a period, say of 5 to 7 years.

Fixed Assets : Fixed assets, usually, are shown in accounts at cost less depreciation but the accounts do not show the ages of different assets. It is desirable, therefore, to obtain age analysis of various items of fixed assets. Assets which are old or are obsolete would naturally have to be replaced. It should be seen that their values are not in excess of the value of service that they could be expected to render to the business during the balance period of their active life and the amount they would fetch on sale as scrap.

Stock and work-in-progress : It should be seen that stocks have been valued consistently and that the basis of valuation was such that the value placed on stocks did not include any element of profit. Also, there should be due allowance for damaged, obsolete and slow moving stocks.

Other liquid assets : It should be ascertained that the assets so described are readily realisable. Money with a bank in liquidation should be taken only to the extent guaranteed by Deposit Insurance Scheme.

Idle assets : On a scrutiny, it may appear that certain assets are remaining idle and are not being properly applied in the business. For example, certain plant and machinery may have been put to use after a considerable period of time after acquisition. Some of the fixed assets may be awaiting installation even at the valuation time.

Liabilities : The important matter to investigate in this regard is whether those are stated fully or understated or overstated. In other words, whether the profits of the business have been inflated by suppression of liabilities or there are any free reserves included in the liabilities. In either case, an adjustment would be necessary. Secondly, it should be ascertained that liabilities are not unduly 'large or are not outstanding for a long time, in such cases, it would be necessary to pay off some of them which would cause a drain on the liquid resources of the concern. The fact should be stated in the report.

Taxation : Orders in respect of assessments completed should be studied and it should be verified that an adequate provision has been made in respect of liabilities for taxes which have not been assessed. Also,

it should be seen that in the past there has been no reopening of assessments. If so, the company may be liable for an undisclosed sum of taxes plus penalties. Any temporary tax benefit should also be disregarded.

Apart from the above areas, the other factors relating to the management, skilled labour, etc. may also be covered in the investigation.

Q. 30. (a) Suggest the list of items to be included in the report on Corporate Governance in The Annual Report of Companies.

(b) State the important characteristics of an effective system of Computer Audit Programme.

Answer 30. (a)

Suggested List of Items to be included in the Report on Corporate Governance in the Annual Report of Companies :

1. A brief statement on company's philosophy on code of governance.
2. **Board of Directors :**
 - (i) Composition and category of directors, for example, promoter, executive, non- executive, independent non-executive, nominee director, which institution represented as lender or as equity investor.
 - (ii) Attendance of each director at the Board meetings and the last AGM.
 - (iii) Number of other Boards or Board Committees in which he/she is a member or Chairperson.
 - (iv) Number of Board meetings held, dates on which held.
3. **Audit Committee :**
 - (i) Brief description of terms of reference.
 - (ii) Composition, name of members and Chairperson.
 - (iii) Meetings and attendance during the year.
4. **Remuneration Committee :**
 - (i) Brief description of terms of reference.
 - (ii) Composition, name of members and Chairperson.
 - (iii) Attendance during the year.
 - (iv) Remuneration policy.
 - (v) Details of remuneration to all the directors, as per format in main report.
5. **Shareholders Committee :**
 - (i) Name of non-executive director heading the committee.
 - (ii) Name and designation of compliance officer.
 - (iii) Number of shareholders' complaints received so far.
 - (iv) Number not solved to the satisfaction of shareholders.
 - (v) Number of pending complaints.
6. **General Body meetings :**
 - (i) Location and time, where last three AGMs held.
 - (ii) Whether any special resolutions passed in the previous 3 AGMs.
 - (iii) Whether any special resolution passed last year through postal ballot – details of voting pattern.

- (iv) Person who conducted the postal ballot exercise.
- (v) Whether any special resolution is proposed to be conducted through postal ballot.
- (vi) Procedure for postal ballot.

7. Disclosures :

- (i) Disclosures on materially significant related party transactions that may have potential conflict with the interests of company at large.
- (ii) Details of non-compliance by the company, penalties, strictures imposed on the company by Stock Exchange or SEBI or any statutory authority, on any matter related to capital markets, during the last three years.
- (iii) Whistle Blower policy and affirmation that no personnel has been denied access to the audit committee.
- (iv) Details of compliance with mandatory requirements and adoption of the non-mandatory requirements of this clause.

8. Means of communication :

- (i) Quarterly results
- (ii) Newspapers wherein results normally published.
- (iii) Any website, where displayed.
- (iv) Whether it also displays official news releases; and
- (v) The presentations made to institutional investors or to the analysts.

9. General Shareholder information :

- (i) AGM : Date, time and venue
- (ii) Financial year
- (iii) Date of Book closure
- (iv) Dividend Payment Date
- (v) Listing on Stock Exchanges
- (vi) Stock Code
- (vii) Market Price Data : High., Low during each month in last financial year
- (viii) Performance in comparison to broad-based indices such as BSE Sensex, CRISIL index etc.
- (ix) Registrar and Transfer Agents
- (x) Share Transfer System
- (xi) Distribution of shareholding
- (xii) Dematerialization of shares and liquidity
- (xiii) Outstanding GDRs/ADRs/Warrants or any Convertible instruments, conversion date and likely impact on equity
- (xiv) Plant Locations
- (xv) Address for correspondence

Answer 30. (b)**Important characteristics of an effective system of computer audit program :**

- (i) The system has to be simple to use and eliminate the need to remember countless details normally required in writing or revising computer programs.

- (ii) It has to be easily understandable even by those with little computer expertise and easy to use.
- (iii) It has to be capable of being used with different configuration of computers.
- (iv) The package has to include adequate support at the time of installation, provide adequate training to the staff and to provide documentation. There should be a provision for future revision of the program.
- (v) The package should have statistical sampling capability.
- (vi) The system has to be acceptable to all users in terms of easy execution and compatible with the existing system.
- (vii) The program has to be capable of processing different types of applications.
- (viii) The program should have strong report writing function including the ability to prepare multiple reports in a single program run and to generate flexible output report formats.

