FINAL EXAMINATION SET - 2

MODEL ANSWERS TERM – DECEMBER 2024

PAPER – 17 SYLLABUS 2022

COST AND MANAGEMENT AUDIT

Time Allowed: 3 Hours Full Marks: 100

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

SECTION – A (Compulsory)

1.(a) Choose the correct option: [15 x 2 = 30]

(i) The cost auditor of the company who is in default in compliance with section 148 shall be punishable in the manner as provided in ______________________.

A. Section 139 of Companies Act, 2013

B. Sub-sections (1) to (3) of section 148 of Companies Act, 2013

C. Section 143 of Companies Act, 2013

D. Sub-sections (2) to (5) of section 147 of Companies Act, 2013

(ii) Cost Audit was first introduced for__________industry.

A. Cement

B. Iron & Steel

C. Jute

D. Sugar

(iii) The form in which the cost records shall be maintained

A. CRA-1

B. CRA-2

C. CRA-3

D. CRA-4

(iv) Which one of the below is not a regulated industry?

A. Telecommunication

B. Electricity

C. Drugs & Pharmaceuticals

D. Automobile

(v) A person shall not be eligible to be appointed as Cost Auditor of the Company if he has been convicted of an offence involving fraud and a period of ___ years has not elapsed from the date of such conviction

A. 1 year

B. 5 years

C. 7 years
D. 10 years

(vi) Which of the following is not forming part of Cost of transportation?
A. Cost of transport
B. Transit insurance
C. Demurrage Charge
D. Local Octroi charges.

(vii) CAS ___ pertains to Cost of Utilities
A. 1
B. 4
C. 8
D.14

(viii) The work of one clerk is automatically checked by another clerk is called:
A. Internal control
B. Internal audit.
C. Internal check
D. None of the above.

(ix) CAATTS is also known as ____________.
A. Cost and Accounts Treatments
B. Computer Assisted Audit Tools and Techniques
C. Classification and Accounting of Tax Tools
D. Computer Aided Audit Tools and Techniques

(x) Offence of money laundering is defined in which section of PMLA Act, 2002?
A. Section 3
B. Section 2
C. Section 1
D. Section 11

Answer:

i	ii	iii	iv	v	vi	vii	viii	ix	x
D	A	A	D	D	C	C	C	B	A

(b) **DG Solutions Co has the following forecast figures for its first year of trading:**

Sales ₹18,00,000

Purchases expense ₹15,00,000 Average receivables ₹1,53,000 Average inventory ₹2,47,500 Average payables ₹1,15,000 Average overdraft ₹2,50,000

Gross profit margin 25%

Industry average data:

Inventory days 53

Receivables days 23

Payables days 47

Current ratio 1.43

Assume there are 365 days in the year

Choose the correct option based on above information:

(i) **The Cash operating cycle for DG Solutions Co is ___________________.**

A. 65 days
B. 59 days
C. 70 days
D. 88 days

(ii) **Current Ratio of DG Solutions Co is _______________.**

A. 1.10 times
B. 1.25 times
C. 1.00 times
D. 1.30 times

(iii) **Quick Ratio of DG Solutions Co is ______________.**

A. 0.56 times
B. 0.42 times
C. 0.60 times
D. 1.20 times

(iv) **Sales to Working Capital Ratio of DG Solutions Co is _____________.**

A. 5.60 times
B. 6.30 times
C. 7.69 times
D. 5.75 times

(v) From the above calculations and the given scenario, which one of the statement is most correct?

A. The length of the cash operating cycle is longer than the industry average, which is likely to lead to liquidity problems

B. Liquidity position is favourable

C. Liquidity position is better than the industry standard

D. Resources are efficiently utilized

Answer:

i	ii	iii	iv	v
C	A	B	B	A

SECTION – B

(Answer any five questions out of seven questions given. Each question carries 14 Marks) [5x14=70]

2. (a) What are the objectives of Cost Audit? Explain. [7]

Answer:

Cost Audit has both general and social objectives:

General Objectives:

- Verification of cost accounts with a view to ascertaining that these have been properly maintained and compiled according to the cost accounting system followed by the enterprise.
- Ensuring that prescribed procedures of the cost accounting records rules are duly adhered to.
- Detection of errors and fraud.
- Verification of the cost of each "cost unit" and "cost center" to ensure that these have been properly ascertained.
- Determination of inventory valuation.
- Facilitating the fixation of prices of goods and services.
- Periodical reconciliation between cost accounts and financial accounts.
- Ensuring optimum utilization of human, physical and financial resources of the enterprise.
- Detection and correction of abnormal loss of material and time.

- Advising management, on the basis of inter-unit/inter-firm comparison of cost records, as regards the areas where performance calls for improvement.
- Promoting corporate governance through various operational disclosures to the directors.
- Helping the entity in matters of Anti-Dumping Duty, valuation of cost of production of goods and services, anti-profiteering (e.g. GST), price controls (e.g. Pharma industry in the past), etc.

Socials Objectives:

- Verifying whether the pricing of the products are justified as per the product and quality are concerned,
- Removing the disparities, if any, in the pricing of products and/or services.
- Looking into that no cost based economic imbalance may occur in product and /or services.
- Facilitating in the global market cost competitiveness of the products.
- Ensuring the efficient utilization of resources.

(b) Explain the treatment of Finance costs according to the guidelines provided [i.e. Companies (Cost Records and Audit) Rules, 2014] . [7]

Answer:

- Finance costs are costs incurred by an enterprise in connection with the borrowing of fund or other costs which in effect represent payment for the use of non- equity fund.
- Finance costs incurred shall be identified for-
  - ✓ acquisition or construction or production of qualifying assets including fixed assets; and
  - ✓ other finance costs for production of goods or operations or services rendered which cannot be classified as qualifying assets.
- Finance costs directly attributable to the acquisition or construction or production of a qualifying asset shall be included in the cost of the asset.
- Finance costs shall not include imputed costs.
- Subsidy or grant or incentive and any such payment received or receivable with respect to finance costs shall be reduced from cost of the cost object in the financial year when such subsidy or grant or incentive and any such payment is recognised as income.
- Penal Interest for delayed payment, fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the finance costs. In

case the company delays the payment of statutory dues beyond the stipulated date, interest paid for delayed payment shall not be treated as penal interest.

- Interest paid for or received on investment shall not form part of the other financing charges for production of goods or operations or services rendered;
- Assignment of finance costs to the cost objects shall be based on either of the following two principles; namely: -
  - ✓ Cause and Effect - Cause is the process or operation or activity and effect is the incurrence of cost and
  - ✓ Benefits received - to be apportioned to the various cost objects in proportion to the benefits received by them.

3. (a) Discuss Duties of a Cost Auditor to Report fraud as per Section 143 of The Companies Act, 2013. [7]

Answer:

(i) According to Section 143(12) of the Companies Act 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within such time and in such manner as may be prescribed.

(ii) Sub-Section 13 specifies that no duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred to in sub-section (12) if it is done in good faith.

(iii) Sub-Section 14 makes it clear that the provisions of this section shall mutatis mutandis apply to the cost accountant in practice conducting cost audit under section 148.

(iv) According to Sub-Section 15 if any auditor, cost accountant or company secretary in practice do not comply with the provisions of sub-section (12), he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

(v) Matter are required to be reported immediately but not later than 2 days of his knowledge specifying:

a) Nature of Fraud with description;
b) Approximate amount involved; and
c) Parties involved.

(vi) Following disclosures are required to be made in Board's Report:

a) Nature of Fraud with description;
b) Approximate Amount involved;
c) Parties involved, if remedial action not taken; and
d) Remedial actions taken.

(b) Explain the Conversion of cost audit report into the XBRL format. [7]

Answer:

XBRL is the open international standard for digital business reporting, managed by a global not for profit consortium called "XBRL International". XBRL is used around the world, in more than 50 countries. Millions of XBRL documents are created every year, replacing older, paper-based reports with more useful, more effective and more accurate digital versions. The change from paper, PDF and HTML based reports to XBRL is like the change from film photography to digital photography, or from paper maps to digital mapss.

➢ XBRL is an open source technology. Any of the following methods can be adopted to create the instance document required for filing of the respective reports.
  - XBRL-enabled software packages developed by different software vendors which support the creation of cost reports in XBRL format can be used to create the necessary document.
  - Various elements of Cost Audit Report and Compliance Report can be mapped into XBRL tags of the costing taxonomy using specialised XBRL software tools specifically designed for this purpose.
  - Different third party packages can be integrated into the existing accounting systems to generate XBRL Cost statements.
  - There are various web based applications available that take input reports in various formats viz. Microsoft Excel etc. and transform them into XBRL format.

The methodology adopted by an individual company will depend on its requirements and the cost accounting software and systems being used and other factors.

4. (a)The following information pertains to ASHOKA CEMENT LTD., a manufacturing cement company for the year that ended as follows:

The year ended March 31	**2023-24**	**2022-23**
Rated Capacity per Hr. (in MT)	**80**	**80**
Break down (Hrs.)	**2,177**	**1,015**
Planned Maintenance (Hrs.)	**247**	**422**
Power restrictions (Hrs.)	**1,237**	**1,481**
Shortfall (there are no orders) (Hrs.)	**792**	**677**
Want of wagons (Hrs.)	**495**	**635**
Total stoppage (Hrs.)	**4,948**	**4,230**
Total running (Hrs.)	**3,888**	**4,582**

Total available Hours	**8,836**	**8,812**
Production during the year (in MT)	**2,48,844**	**3,29,928**
Hourly Rate of Production (in MT)	**64**	**72**
Capacity Utilization (%)	**62.21**	**82.48**
Annual Installed Capacity (in MT)	**4,00,000**	**4,00,000**

Based on information stated above, you as a Cost Auditor are required to offer your comments on:

(i) The performance of the company

(ii) Your suggestion for improvement. [7]

Answer:

Ashoka Cement Ltd.

Performance analysis

(i)

(a) **Rated capacity** = 80 MT/Hr: Rated capacity achieved in 2022-23 = (72/80) × 100 = 90%

Rated capacity achieved in 2023-24 = (64 /80) × 100 = 80%. The capacity achievement as % of rated capacity has declined from 90% to 80% in 2023-24.

Further the Capacity Utilization has gone down to 62.21% in 2023-24 from 82.48% of previous year; a reduction of 20.27%.

(b) **From the data available the following observations are noted: -**

1. Breakdown hours have gone up from 1,015 hours to 2,177 hrs, an increase by 114.48%
2. Planned Maintenance hrs has reduced from 422 hrs to 247 hrs i.e. by 41.47%
3. Shortfall hrs due to lack of orders has increased from 677 hrs to 792 hrs i.e. by 16.99%
4. The total stoppage hrs. has increased from 4,230 hrs to 4,948 hrs i.e. by 16.97%
5. The total running hrs has come down from 4,582 hrs to 3,888 hrs i.e. by 15.15%
6. The production has come down from 3,29,928 MT to 2,48,844 MT i.e. by 24.58% From the above findings, it can be pointed out that the underutilization of capacity to the extent of little over 20% can be attributed mainly to:
   - Increased total stoppage hours of 4,948 of 2023-24 as against that of 4,230 hrs in 2022-23 and
   - The net increase of 718 hrs (4,948-4,230) is again due to increase of break down by 1,162 hrs (2,177-1,015) in the year 2023-24

(ii) Suggestion:

Therefore, the Company should look into the aspect of proper maintenance, securing sufficient orders to avoid lost time. Better utilization of capacity can be also be achieved by improving availability of wagons. The company may also carry out a cost-benefit analysis to have captive source of power.

(b) VIDESH ELECTRONICS LTD. is engaged in the manufacture of LED TV sets having its factories at Patna and Gujarat. The company manufactures picture tube at Patna which is consumed to produce LED TV sets at Gujarat factory. The following information pertaining to captively consumed picture tubes are extracted from the records of the company for the half year ended March 31, 2024.

Particulars	₹'000
Direct material	950
Direct wages and salaries	357
Direct expenses	80
Indirect materials	70
Factory overheads	320
Administrative overheads (20% relating to production activities)	640
Quality control cost	100
Research and development cost	125
Selling and distribution expenses	225
Sale of scrap realized	130
Profit margin	15%

You are required to determine:

(i) The cost of production for purpose of captive consumption in terms of Rule 30 of the Central Goods & Services Tax Rules 2017 and as per CAS-4 (Revised), and

(ii) Assessable Value for the purpose of paying GST on applicable transactions. [7]

Answer:

VIDESH ELECTRONIC LTD.

Computation of Cost of Production (As per CAS-4)

Particulars	₹'000
Direct materials	950
Direct wages and salaries	357
Direct expenses	80

Factory overheads (320+70)	390
Quality control cost	100
Research and development cost	125
Administrative overheads (to the extent relates to Production activities)	128
Less: Sale of scrap realized	(130)
Cost of production	**2,000**
Add: 10% as per Rule 30 of CGST Rules, 2017 (10% of ₹2,000)	200
Assessable Value as per Rule 30 of CGST Rules, 2017	**2,200**

5.(a) The Financial Profit and Loss of M/s. VGM Manufacturing company Ltd. for the year is ₹28,75,000. During the course of cost audit, it is noticed the followings:

(i) Some Old assets sold off which fetched a profit of ₹1,25,000

(ii) Interest was received amounting to ₹45,000 from outside the business investment.

(iii) Work-in-progress valuation for financial accounts does not as a practice take into account factory overhead. Factory overhead is ₹2,15,000 in opening W-I-P and ₹2,45,000 in closing W-I-P.

(iv) The Company was engaged in Trading activity by purchasing goods of ₹11,15,845 and selling at ₹13,12,850 after incurring ₹35,000 as expenditure.

(v) A major overhaul of machinery was carried out at a cost of ₹5,50,000 and next such overhaul will be done only after five years.

(vi) Opening stock of raw material and finished goods was overvalued for ₹2,00,000 and closing stock was overvalued ₹1,85,000 in financial records.

Work out the profit as per Cost Accounts. [7]

Answer:

Reconciliation of Profit between Cost Accounts and Financial Accounts of M/s. VGM Manufacturing Company Ltd.

Particulars	₹	₹
Profit as per Financial Accounts		28,75,000
Add: Difference in valuation of W-I-P	30,000	
Proportionate charge i.e. four-fifth for overhaul of machinery	4,40,000	
Overvaluation of Opening Stock in the financial records	2,00,000	6,70,000
Less: Profit on sale of old assets not included in Cost A/cs	1,25,000	
Interest received from outside investment	45,000	
Trading profit not included in cost accounts	1,62,005	
Overvaluation of closing stock in the financial records	1,85,000	(-) 5,17,005
Profit as per Cost Accounts		**30,27,995**

(b) Discuss the nine steps involved in the investigation methodology of a forensic audit. **[7]**

Answer:

The forensic audit investigation is the utilization of specialized investigation skills to conduct the forensic audit engagements in such a manner that the outcome can be presented in a court of law as evidence. The auditor should use an approach considering both the aspects of whether the fraud could have occurred and whether the fraud could not have occurred. With this approach, the forensic auditors will be able to bring the reality closer to the general, public especially the circumstances where perception and reality are not aligned. An auditor can follow a nine-step method for fact-finding in case of forensic audit engagements:

- Accept the forensic audit engagement.
- Evaluate the allegations or suspicions.
- Conduct due diligence background notes.
- Complete the preliminary stage of the investigation.
- Check the prediction assuming that there will be litigation.
- Begin with an external investigation.
- Gathering the required proofs and evidence.
- Preparing report on findings; and
- Court proceedings.

6. (a) Summarize the records that are require to be maintained by reporting entity under Prevention of Money- Laundering Act (PMLA), 2002 and how long these records have to be maintained? **[7]**

Answer:

The law (PMLA, 2002) defines reporting entities as banks, financial institutions, those operating games of chance for reward, casinos, real estate agents, precious metal dealers and persons carrying on a designated business or profession. Every banking company, financial institution, intermediary, or a person carrying on a designated business or profession ("Reporting Entity") is required to verify the identity of their clients and the beneficial owner, maintain records of all transactions and documents evidencing identity of its clients as well as beneficial owners and periodical furnishing of information related to certain transactions. **The records maintained must contain information including**:

a. The nature of the transactions;

b. The amount of the transaction and the currency in which it was denominated;

c. The date on which the transaction was conducted and

d. The parties to the transaction to enable the Reporting Entity to reconstruct individual transactions.

The information relating to the transaction must be maintained for five years from the date of the transaction between a client and the Reporting Entity. The records relating to the identity of clients and beneficial owners as well as account files and business correspondence must be maintained for five years after the business relationship between a client and the Reporting Entity has ended or the account has been closed, whichever is later.

(b) Describe the functions of the Management Audit. **[7]**

Answer:

Management audit is a difficult and complex task. It performs the following functions:

- Management audit requires a tight rope walking with clear, identified roles to perform while dealing with top management.
- It examines all the scope of work with respect to areas for review. In this regard, the auditor should help management in pinning down and inter-relating the performance standards and measurements with the ownership of responsibilities.
- Management audit provides valuable suggestions to the management after proper evaluation.

The aim of management audit is apprising a function or department or activity with a view to judge how effectively and efficiently these are discharged with reference to:

- The narrower departmental goals or objectives
- In the broader and larger context of the company as a whole

Management audit is concerns with apprising / judging the effectiveness / efficiency of following functions / departments / activities (List is Illustrative and not exhaustive)

- Marketing including selling and distribution
- Manufacturing including Planned Maintenance, Capacity Utilisation

- Procurement including Development of New Vendors
- Project Management including its timely cost effective implementation
- Inventory Control to ensure sustainable production / sales
- Finance including arranging finance for working capital and for project capital
- Research and Development to contribute to new product, process improvement, cost reduction etc.
- Insurance including adequate insurance for all assets against insurable perils
- Personnel management including selection, recruitment, training, developments, motivation and retention of human resources.

7. (a) Explain the Merits and Demerits of ESG. **[7]**

Answer:

The SEBI introduced the requirement of ESG reporting way back in 2012 and mandated that the top 100 listed companies by market capitalisation shall file a BRR.

This was later extended to top 500 listed companies by market capitalisation in 2015.

Further, in May 2021, SEBI introduced a new reporting requirements on ESG parameters under the Business Responsibility and Sustainability Report (BRSR) by amending regulation 34 (2) (f) of SEBI (Listing Obligation and Disclosure Requirements) Regulation 2015, (LODR Regulations), however following are the Merits and Demerits of ESG:

Merits of ESG:

- **Enhanced Reputation**
  Employing ESG principles can aid businesses in enhancing their reputation as ethical corporate citizens, customers, investors, and employees who value ethical and sustainable business practices may become more attracted as a result.

- **Risk Reduction**
  ESG practices can assist businesses in identifying and reducing possible risks, including those related to environment, the supply chain and reputation.

- **Saving money**
  Using ESG practices can save money in areas including energy use, waste reduction, and employee retention.

- **Long Term Value Creation**
  By putting ESG policies into practice, businesses may generate value for all parties involved including communities, employees, and shareholders.

Demerits of ESG:

- **Cost associated with implementation**
  Small and medium sized businesses, who may lack the business resources to invest in sustainable practices, may find it particularly expensive to implement ESG principles.
- **Lack of Standardisation**
  Because there is currently no agreed upon frame work for ESG practises, it can be challenging for businesses to assess and bench mark their performance.
- **Focus on Short Term**
  Some businesses may place a higher priority on immediate financial results than on long-term sustainability objectives, which can lead to a lack of dedication to ESG Compliance.

(b) Describe the objectives of Environmental Audit. **[7]**

Answer:

Prime objective of Environment Audit is to protect 'mother nature' and minimize the negative impact on environment for undertaking industrial activities. Regulatory requirements are mostly in place, however, mere compliance may not be fruitful in the longer term.

The environmental audit aims at evaluating and reporting key environmental performance measures like pollution control measures, energy conservation or waste management techniques, conservation of scarce natural resources, etc.

The following are major objectives of environmental auditing:

- Determine and document compliance status.
- Help to improve environmental performance at operational facilities.
- Assist facility management.
- Increase the overall level of environmental awareness.
- Accelerate the overall development of the environmental management control system.
- Improve the risk management systems.

- Protect the corporation from potential liabilities on breaches.
- Conservation policy and application guidance.
- Fund allocation (Capex and Opex) and utilization w.r.t environment protection.
- Develop a basis for optimizing environmental resources.

8. (a) Explain the advantages of Audit Working Paper Files. **[7]**

Answer:

Audit Working Paper Files, often simply referred to as working papers, are formal documents and records that auditors prepare and maintain during the course of an audit. These files serve as a comprehensive and organized documentation of the audit procedures performed, the evidence obtained, and the conclusions reached by the auditors.

Here are some key advantages / benefits

- **Evidence of Due Diligence**

Working papers provide evidence that the audit was conducted with due professional care and in accordance with auditing standards.

- **Reference for future audits**

Documentation in working papers can be a valuable guide for future audits.

- **Legal Compliance**

Working Papers help auditors demonstrate compliance with legal requirements

- **Training Tools for new auditors**

They provide examples of how audit procedures are documented and help transfer knowledge and best practices within the audit team.

- **Facilitation of External Reviews**

Well-prepared working papers contribute to a smoother and well efficient external review process

- **Record of Adjustments and Reconciliations**

Working papers document any adjustments and reconciliations performed as may be proposed by the auditor which contributes to the reliability of financial statements

(b) Discuss the basic standards set for Government Expenditure Audit. **[7]**

Answer:

Audit of government expenditure is one of the major components of government audit conducted by the office of C&AG. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorised by competent authority fixing the limits within which expenditure can be incurred. Briefly, these standards are explained below:

- **Audit against Rules & Orders:** The auditor has to see that the expenditure incurred conforms to the relevant provisions of the statutory enactment and is in accordance with the financial rules and regulations framed by the competent authority.
- **Audit of Sanctions:** The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, accorded by the competent authority, authorising such expenditure.
- **Audit against Provision of Funds:** It contemplates that there is a provision of funds out of which expenditure can be incurred and the amount of such expenditure does not exceed the appropriations made.
- **Propriety Audit:** It is required to be seen that the expenditure is incurred with due regard to broad and general principles of financial propriety. The auditors aim to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. Audit aims to secure a reasonably high standard of public financial morality by looking into the wisdom, faithfulness and economy of transactions.
- **Performance Audit:** This involves that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them. Efficiency-cum-performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater economy, and effectiveness