FINAL EXAMINATION — SET - 1

MODEL ANSWERS — TERM – JUNE 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.
Answer Question No. 1 and any five from Question No. 2, 3, 4, 5, 6, 7 and 8.

SECTION – A (Compulsory)

1.(a) Choose the correct alternative. **[15 x 2 = 30]**

(i) A Cost Accountant who fails to comply with the provisions of sub-section (12) of Sec. 143 of the Companies Act, 2013, shall be punishable with fine of maximum ___________.
A. ₹5.00 lakhs
B. ₹25.00 lakhs
C. ₹1.00 lakhs
D. ₹10.00 lakhs

(ii) Which one of the below is not a regulated industry?
A. Telecommunication
B. Electricity
C. Drugs & Pharmaceuticals
D. Automobile

(iii) The Cost Auditing Standard which deals with Knowledge of business, its processes and the business environment:
A. 101
B. 102
C. 103
D. 104

(iv) CAS 9 deals with:
A. Direct Expenses
B. Pollution Control Cost
C. Packing Material Cost
D. Employee Cost

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

(vi) Under the Generally Accepted Cost Accounting Principles, the cost of cane supplied from own farm to the sugar mill is treated as:
A. Direct Material Cost
B. Indirect Material Cost
C. Production Overhead
D. Production Overhead

(vii) Which of the following is not part of the Employee Cost as per CAS-7?
A. Leave with Pay
B. Medical benefits to the Employees and dependents
C. Compensation for Lay off period
D. Cost of Employees' stock option

(viii) Co-operative Auditor has to examine the overdue debts if any, and a valuation of the assets and liabilities of the society while conducting an internal audit as per:
A. Section 17(3) of the Cooperative Societies Act, 1912
B. Section 17(2) of the Cooperative Societies Act, 1912
C. Section 17(5) of the Cooperative Societies Act, 1912
D. Section 37(2) of the Cooperative Societies Act, 1912

(ix) Aspects may be taken into consideration for proper inventory control
A. Maximum, minimum and reorder level fixation.
B. Fixed order quantity system and different replenishment systems.
C. Fast-moving, slow-moving and non-moving analysis, etc.
D. All of the above

(x) As per section 5 of PMLA Act, 2002, the property can be provisionally attached for a period not exceeding ______ from the date of the order.
A. 60 days
B. 90 days
C. 120 days)
D. 180 days

Answer:

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

(b) Following data available from product wise profitability statement:

Particulars	₹ Per Unit
Sale	100000
Raw Material	50000
Utilities	15000
Packing Material	5000
Employee Cost	5000
Consumable Stores	4000
Repair Expenses	3000
Depreciation	5000
Insurance	1000
Overheads	2000

(i) **What is the variable cost of the product?**
A. ₹ 50000 Per Unit of Finished Product
B. ₹ 60000 Per Unit of Finished Product
C. ₹ 70000 Per Unit of Finished Product
D. ₹ 80000 Per Unit of Finished Product

(ii) **What is the Fixed cost of the product**
A. ₹ 10000 Per Unit of Finished Product
B. ₹ 20000 Per Unit of Finished Product
C. ₹ 25000 Per Unit of Finished Product
D. ₹ 30000 Per Unit of Finished Product

(iii) **What is the Contribution of the product**
A. ₹ 10000 Per Unit of Finished Product
B. ₹ 20000 Per Unit of Finished Product
C. ₹ 25000 Per Unit of Finished Product
D. ₹ 30000 Per Unit of Finished Product

(iv) **What is the Profitability of the product**
A. ₹ 10000 Per Unit of Finished Product
B. ₹ 20000 Per Unit of Finished Product
C. ₹ 25000 Per Unit of Finished Product
D. ₹ 30000 Per Unit of Finished Product

(v) **What is Raw Material Cost as % of Total Cost**
A. 54.56
B. 55.56
C. 56.56
D. 57.56

Answer:

i	ii	iii	iv	v
C	B	D	A	B

SECTION – B

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

2. (a) How cost information helps the organization and management? [7]

Answer:

Cost information helps the organization and management in the following way:

(i) Cost information enables the organization to structure the cost, understand it and use it for communicating with stakeholders

(ii) Costing is an important tool in assessing organizational performance in terms of Shareholder and stakeholder value. It informs how profit and value are created, and how efficiently and effectively operational processes transform input into output. It contributes to the data input on economy level parameters like resources efficiency, waste management, resources allocation policies etc.

(iii) Costing includes product, process, and resource-related information covering the functions of the organization and its value chain. Costing information can be used to appraise actual performance in the context of implemented strategies.

(iv) Good practice in costing should support a range of both regular and non- routine decisions when designing products and services to:
- Meet customer expectations and profitability targets;
- Assist in continuous improvements in resources utilization; and
- Guide product mix and investment decisions.

(v) Working from a common data source (or a single set of sources) also helps to ensure that output reports for different audiences are reconcilable with each other.

(vi) Integrating databases and information systems can help to provide useful costing information more efficiently as well as reducing source data manipulation.

(b) Discuss about the applicability for Cost Audit. [7]

Answer:

(1) Every company specified in item (A) of rule 3 shall get its cost records audited in accordance with these rules if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is rupees fifty crore or more and the aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained under rule 3 is rupees twenty-five crore or more.

(2) Every company specified in item (B) of rule 3 shall get its cost records audited in accordance with these rules if the overall annual turnover of the company from all its products and

services during the immediately preceding financial year is rupees one hundred crore or more and the aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained under rule 3 is rupees thirty-five crore or more.

(3) The requirement for cost audit under these rules shall not apply to a company which is covered in rule 3; and

(i) whose revenue from exports, in foreign exchange, exceeds seventy-five per cent of its total revenue; or

(ii) which is operating from a special economic zone;

(iii) which is engaged in generation of electricity for captive consumption through Captive Generating Plant. For this purpose, the term "Captive Generating Plant" shall have the same meaning as assigned in rule 3 of the Electricity Rules, 2005.

3. (a) As per Section 143 of the Companies Act, 2013, explain the duties of a Cost Auditor to report fraud. [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) Classify the contents of Cost Audit Documentation. **[7]**

Answer:

The Cost Audit Documentation will usually contain:

(i) Check lists i.e. Checklist of compliance with:

(1) The Rules, regarding maintenance of Cost Records, as prescribed under the Companies Act,

(2) The Cost Accounting Standards (CAS) as prescribed by the Institute

(3) The Generally Accepted Cost Accounting Principles (GACAP) as prescribed by the Institute

(ii) Audit programs

(iii) Analysis Cost Audit relies more on analytical review than on substantive testing to establish true and fair view.

(iv) Audit Query List containing a log of audit queries raised and their resolution

(v) Abstracts of significant contracts relating to costs and revenues

(vi) Letters of confirmation

(vii) Letter of Representation from Management Correspondence (including e-mail) concerning significant matters.

(viii) Abstract or copies of the entity's records.

4. (a) Standard Material requirement to produce 1000 units of product X is 1200 units of material at a standard price of ₹ 60 per unit. The Standard allows for reject of 25% of input. It is estimated that one third of rejects can be reworked at an additional cost of ₹ 20 per unit. Scrap units can be sold at ₹ 5 per unit.

During a particular period, units produced were 19500 with 24000 units of materials at standard cost of ₹ 60 per unit, 7000 units were rejected out of which 2500 units were reworked at a cost of ₹ 51,000. The balance units were sold as scrap for ₹ 5 per unit.

Calculate Material Quality Variance and Scrap Variance. **[7]**

Answer:

Quality control cost is the cost of resources used for quality control procedures.

Standard Material Cost:

Units	Particulars	Amount
Material 1200 units	Standard Cost (₹)	72,000
Rejection 300 units		
Reworked Unit =100	Rework cost (₹)	2,000
Scrap of 200 units	Sale value of scrap (₹)	-1,000
		₹ 73,000
Unit Produced 1000 (1200 - 200)	Standard Cost per unit	₹ 73.00

Actual Material Cost:

Units	Particulars	Amount
Material 24000 units	Actual Cost (₹)	14,40,000
Rejection 7000 units		
Reworked Unit = 2500	Rework cost (₹)	51,000
Scrap of 4500 units	Sale value of scrap (₹)	-22,500
		₹ 14,68,500
Unit Produced 19500 (24,000 - 4,500)	Actual Cost per unit	₹ 75.31

Material Quality Variance = Actual Material Cost – Actual Quantity × Std Rate
= ₹ 14,68,500 – (19500 × 73) = 14,68,500 – 14,23,500 = ₹ 45,000 (A)

Material Usage Variance = Actual Quantity × Standard Rate – Standard Quanity × Std Rate
= Standard Rate (Actual Quantity – Standard Quantity) = 60 × [24,000 – (19,500 × 6/5)]
= 60 × (24,000 – 23,400) = 60 × 600 = ₹ 36,000 (A)

For Scrap Variance
Actual scrap = ₹ 22,500
Scrap value as per standard = 19,500 × (1/5) × 5 = ₹ 19,500
Scrap Variance = ₹ 3,000 (F)
Material cost/unit = ₹ 72,000 ÷ 1200 = ₹ 60/unit

(b) A plant operates 3 shifts of 8 hours each for all days except Sundays and 8 holidays.

Preventive maintenance is taken care in Sundays and annual maintenance in 8 hoildays.

Normal idle time for food, shift change and other work for the workers is 1 hour per shift.

Installed Capacity of the machine = 1200 units per hour.

Production during last 5 years & Current year are 69.4, 72.6, 71.4, 70.5, 70.8, 69.9 lakh units

Determine according to CAS 2, Installed capacity, Actual capacity, Idle capacity, Abnormal idle capacity. **[7]**

Answer:

(i) Installed capacity = days in year × working hours per day × unit per hour
= 365 × 8 × 3 × 1200 unit = 105.12 lakh units

(ii) Available capacity = days available × available hour per shift × shifts × units per hour
= (365 – 52 – 8) × (8 – 1) × 3 × 1200 = 76.86 lakh units

(iii) Normal capacity = 69.4 + 72.6 + 71.4 + 70.5 + 70.8 / 5 = 70.94 Lakhs units

(iv) Actual capacity = Current production / Installed capacity = 69.9 / 105.12 = 66.50 %

(v) Idle capacity = Installed capacity – Actual capacity = 105.12 – 69.90 = (35.22/105.12) × 100 = 33.50%

(vi) Abnormal Idle capacity = Normal capacity – Actual capacity
= 76.86 – 69.9 = 6.96 lakh units

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) **Describe the constituents of Forensic Audit.** **[7]**

Answer:

The constituents of Forensic Audit are given below:

(i) Assessment of fraud risk factors and evaluating internal controls and standards.

(ii) Comparison and contrast of various fraud schemes to devise the appropriate internal controls.

(iii) Developing off-setting internal controls that would limit or prevent these fraud schemes.

(iv) Using data analysis techniques to identify high-risk transactions for further review and investigation.

(v) Evaluating internal controls and identifying ways to plan audits to take advantage of available information systems resources.

(vi) Evaluating financial and program risk for potential fraud.

(vii) Applying various evidence-gathering techniques used to detect fraud.

(viii) Justifying the auditor's conclusion of fraud by providing the evidence needed to support legal and investigative staff.

(ix) Documenting the evidence and data-gathering process.

(x) Sharing the findings with the agency and advise them on how to avoid the fraud in the future.

6. (a) Describe how money laundering works. [7]

Answer:

To identify and report potential money laundering and address compliance requirements, financial institutions must have a deep understanding of how the crime works. Money laundering involves three stages:

i. Placement
ii. Layering
iii. Integration.

These are a complex series of transactions that start with depositing funds, then gradually moving them into what appear to be legitimate assets.

Placement refers to how and where illegally obtained funds are placed. Money is often placed via Payments to cash-based businesses; payments for false invoices; "smurfing," which means putting small amounts of money (below the AML threshold) into bank accounts or credit cards; moving money into trusts and offshore companies that hide beneficial owners' identities; using foreign bank accounts, and aborting transactions shortly after funds are lodged with a lawyer or accountant.

Layering refers to separating criminal funds from their source. It involves converting the illicit proceeds into another form and creating complex layers of financial transactions to disguise the funds' origin and ownership. Criminals do this to obfuscate the trail of their illicit funds so it will be hard for AML investigators to trace the transactions.

Integration refers to the re-entry of the laundered funds into the economy in what appears to be normal, legitimate business or personal transactions. This is sometimes done by investing in real estate or luxury assets. It allows launderers and criminals to increase their wealth.

(b) Explain the procedure of Management Audit. [7]

Answer:

Audit procedures should be tailored to the specific needs of each situation examined. The following procedures may be followed for conducting Management Audit:

(i) Clarity of understanding with respect to selected area. Make a preliminary survey of the activity under audit to obtain the necessary background and other working information for use in conducting the audit.
(ii) Responsibility owner and preliminary discussion to understand 'pain points'.
(iii) Data and document collection to align with audit objective/scope.
(iv) Thorough analysis in support of accomplishment of objective.
Study the basic charter or assignment of responsibility of the activity under audit (applicable laws and related legislative history in the case of a government activity) to ascertain the authorized purposes and related authorities of the activity and any applicable restrictions or limitations.
(v) Review pertinent parts of the system of management control by studying the policies established to govern the activities under audit, testing the effectiveness of specific operating and administrative procedures and practices followed, and fully exploring all significant weaknesses encountered.
(vi) Identification of weakness, inaccuracy, process gaps and take it forward for discussion with process owner/ responsible management representative/s.
(vii) Report on the findings of the audit work performed to those responsible for receiving or acting them together with the recommendations for improvement.

7. (a) Identify the major elements of Corporate Image. [7]

Answer:

A corporate image is, of course, the total of impressions left on the company's many publics. In many instances, a brief, casual act by an employee can either lift or damage the corporate image in the eyes of a single customer or caller on the phone, but the overall organisational image is a composite of many thousands of impressions and facts.

The major elements of Corporate Image are:
(i) The core business and financial performance of the company.
(ii) The reputation and performance of its brands ("brand equity").
(iii) Its reputation for innovation or technological prowess, usually based on concrete events.
(iv) Its policies toward its salaried employees and workers.
(v) Its external relations with customers, stockholders, and the community.
(vi) The perceived trends in the markets in which it operates as seen by the public.

Promoter or leadership also acts in favour in building good corporate image. Sometimes a charismatic leader becomes so widely known as a personal lustre to the company.

(b) Briefly discuss the approaches for developing Manpower Planning. [7]

Answer:

(i) Planning for the Status Quo:
Planning involves steps to replace any employees who are either promoted or who leave the firm.

(ii) Thumb Rule:

This is based on the firm's beliefs about forecasting human resource needs.

(iii) Markov Analysis (MA):

Markov chains are a powerful analysis technique that, used in manpower planning, can help it successfully achieve its goal. Markov chains make it possible to predict the size of manpower per category as well as transitions occurring within a given period in the future (resignation, dismissal, retirement, death, etc.).

(iv) Unit Forecasting:

This refers to the estimate of supervisors and managers about forecasting Human resource needs for the next year unit-wise – this approach is called the "Bottom-up approach" for forecasting as the selections are made by lower-level management and added together at a higher level of the organisation.

(v) Ratio Trend Analysis:

The basic principle here is to say if it takes six people, for example, to perform an existing amount of work, it will take twelve people to do twice as much.

(vi) Delphi Method:

This method relies on expert opinion in making long-range forecasts-this involves obtaining independent judgments from a panel of experts usually through a questionnaire or interview schedule on certain issues affecting the nature and magnitude of demand for an organisation's products and services.

(vii) Computer Simulation:

This is one of the most sophisticated methods of forecasting human resource needs. A computer is a mathematical representation of major organisational processes, policies, and human resource movement through organisation-computer simulations are useful in forecasting for human resources by pinpointing any combination of organisational and environmental variables.

(vii) Time and Motion Study:

Here the Industrial Engineer observes records and movement of workman and productivity vis-a-vis time required to conduct specific activities.

(viii) MOST - Maynard Operation Sequence Technique:

This method is well accepted in automobile industries where lots of manual activities are involved. It is based on the walking and moving of the workmen to conduct the specific activity. MOST is an activity-based work measurement system that enables us to calculate the length of time required to perform a task i.e., a system to measure work.

8. (a) Mention the contents of Audit Note Book. [7]

Answer:

An Audit Note Book is a permanent record of the auditor. For each individual audit, the auditor usually maintains a separate audit note book. The audit note book should be maintained clearly, completely and systematically. An audit note book is a great evidential tool available as a defence with the auditors in the event of any charge is brought against them. In case of City Equitable Fire Insurance Company, the auditors were relieved because they have maintained record of the audit work performed at each stage.

Contents of Audit Note Book:

(i) Name of the business enterprise.
(ii) Organisation structure.
(iii) Important provisions of Memorandum and Articles of Association.
(iv) Communication with the previous auditor, if any.
(v) Management representations and instructions.
(vi) List of books of accounts maintained by the enterprise.
(vii) Accounting methods, internal control systems followed by the enterprise, applicable laws etc.
(viii) Key management personnel.
(ix) Errors and fraud discovered.
(x) Matters requiring explanations or clarifications.
(xi) Special points that need attention in the audit report and for subsequent audits.

(b) Explain the basic standards which are required to be 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.

These standards are explained below:

(i) 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.

(ii) 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.

(iii) 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.

(iv) 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.

(v) 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.