

**Paper - 19 : Cost and Management Audit**

## Paper – 19 : Cost and Management Audit

Full Marks : 100

Time allowed: 3 hours

Answer Question No. 1 which is compulsory and carries 20 marks and any five from Question No. 2 to 8.

### Section - A [20 marks]

1. Choose the correct option among four alternative answers. (1 mark for correct choice, 1 mark for justification.) [10\*2=20 marks]

- (i) Cost Auditing Standard 102 deals with \_\_\_\_\_.
- (a) planning an Audit of Cost Statements
  - (b) Cost Audit Documentation
  - (c) knowledge of process and business
  - (d) overall objectives of the Independent Cost Auditor
- (ii) Compensation paid to employees for the past period is \_\_\_\_\_ in Employee Cost.
- (a) included
  - (b) excluded
  - (c) based on individual case
  - (d) partly included
- (iii) The Cost Accounting Standard 14 is a Cost Accounting Standard on \_\_\_\_\_.
- (a) Employee Cost
  - (b) Utilities Cost
  - (c) Pollution Control Cost
  - (d) Selling and Distribution Overheads Cost
- (iv) The figures below are available for Welcome Limited.  
Budgeted Production - 1000 units, Standard Hours per unit -10, Actual Production – 900 units and Actual Working - 7500 hours. What is the Efficiency Ratio?
- (a) 110%
  - (b) 120%
  - (c) 100%
  - (d) 125%
- (v) What is the time limit within which the Cost Auditor of the company should submit his report?
- (a) 90 days
  - (b) 120 days
  - (c) 150 days
  - (d) 180 days
- (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 Materials Cost
  - (b) Indirect Materials Cost
  - (c) Production Overhead
  - (d) Administrative Overhead
- (vii) The Cost Accounting Standard 9 deals with \_\_\_\_\_.
- (a) Material Cost
  - (b) Employee Cost
  - (c) Packing Material Cost
  - (d) repairs and Maintenance Cost

## MTP\_Final\_Syllabus-2016\_June 2019\_Set -1

---

- (viii) \_\_\_\_\_ of the Companies Act 2013 deals with Internal Audit.
- (a) Section 137
  - (b) Section 138
  - (c) Section 139
  - (d) Section 140
- (ix) The Local bodies in India are broadly classified into \_\_\_\_\_ categories.
- (a) Two
  - (b) Three
  - (c) Four
  - (d) Five
- (x) The first step in audit of Educational Institutions \_\_\_\_\_.
- (a) Read through the minutes of the meetings of the Managing Committee or Governing Body
  - (b) Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund
  - (c) Verify the annual statements of accounts
  - (d) To examine the Trust Deed or Regulations

### Answer:

1. (i) (b) Cost Audit Documentation  
Reason: The purpose of the Cost Auditing Standard 102 is to provide guidance to the members in the preparation of audit documentation in the context of the audit of cost statements, records and other related documents.
- (ii) (b) Excluded  
Reason: As per CAS 7, Compensation paid to employees for the past period is not normal cost and hence is excluded from employee cost.
- (iii) (c) Pollution Control Cost  
Reason: CAS - 14 deals with the principles and methods of classification, measurement and assignment of pollution control costs, for determination of Cost of product or service, and the presentation and disclosure in cost statements.
- (iv) (b) 120 %  
Reason: Efficiency Ratio =  $\frac{\text{Standard Hours of actual Production}}{\text{Actual Hours worked}} \times 100$   
=  $[(900 \times 10) / 7500] \times 100 = 120 \%$
- (v) (d) 180 days  
Reason: As per rule 6 (5) of the Companies (Cost Records and Audit) Rules 2014, every Cost Auditor shall forward his signed report to the Board of Directors of the Company within a period of one hundred and eighty days from the closure of the financial year to which the report relates.
- (vi) (a) Direct Material Cost  
Reason: As per the GACAP, Direct Materials Cost includes cost of procurement and freight inwards of the materials.
- (vii) (c) Packing Material Cost  
Reason: CAS - 9 deals with the principles and methods of classification, measurement and assignment of Packing Material Cost, for determination of the cost of product, and the presentation and disclosure in cost statements.

## MTP\_Final\_Syllabus-2016\_June 2019\_Set -1

- (viii) (b) Section 138  
Reason: As per Section 138 of the Companies Act , 2013 an internal auditor, shall either be a Chartered Accountant or a Cost Accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.
- (ix) (a) Two.  
Reason: The Local Bodies in India are broadly classified into two categories. The Local Bodies constituted for local planning, development and administration in the rural areas are referred as Rural Local Bodies (Panchayats) and the Local Bodies, which are constituted for local planning, development and administration in the urban areas are referred as Urban Local Bodies (Municipalities).
- (x) (d) To examine the Trust Deed or Regulations  
Reason: The first step in audit of Educational Institutions Examine is to examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.

### Section - B [80 marks]

2. (a) As per Section 143 of Companies Act, 2013 what is the duty of a Cost Auditor to Report Fraud?
- (b) The Cost Accountant of TRINCUS TEXTILES MILLS LTD. has arrived at a Profit of ₹ 20,10,500 based on Cost Accounting Records for the year ended March 31, 2018. Profit as per Financial Accounts is ₹ 22,14,100.

As a Cost Auditor, you find the following differences between the Financial Accounts and Cost Accounts:

Sl. No.	Particulars	₹
1	Profit on Sale of Fixed Assets	2,05,000
2	Loss on Sale of Investments	33,600
3	Voluntary Retirement Compensation included in Salary & Wages in F/A	50,25,000
4	Donation Paid	75,000
5	Insurance Claim relating to previous year received during the year	5,08,700
6	Profit from Retail trading activity	32,02,430
7	Interest Income from Inter-Corporate Deposits	6,15,000
8	Decrease in value of Closing WIP and Finished goods inventory	
	as per Financial Accounts	3,82,06,430
	as per Cost Accounts	3,90,12,500

You are required to prepare a Reconciliation Statement between the two Accounts for the year ended March 31, 2018. [8 + 8]

Answer:

2. (a) 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.

## MTP\_Final\_Syllabus-2016\_June 2019\_Set -1

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.

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.

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.

Matter to be reported immediately but not later than 2 days of his knowledge specifying:

- (i) Nature of Fraud with description;
- (ii) Approximate amount involved; and
- (iii) Parties involved.

Following disclosures to be made in Board's Report:

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

### 2. (b)

#### Reconciliation of Profit between Cost and Financial Accounts for the year ended March 31, 2018

Particulars	₹	₹	₹
<b>Profit as per Financial Accounts:</b>			<b>22,14,100</b>
Add: Loss on sale of investments		33,600	
Add: Voluntary Retirement compensation included in salary and wages in F/A - Not included in cost A/c		50,25,000	
Add: Donation paid		75,000	<u>51,33,600</u>
			<b>73,47,700</b>
Less: Profit on Sale of Fixed Assets-Not considered in cost A/c		2,05,000	
Less: Receipts of insurance claim related to previous year		5,08,700	
Less: Profit from Retail trading activity		32,02,430	
Less: Interest income from inter-corporate deposit-not considered in cost accounts		6,15,000	
Less: Difference in valuation of stock:			
Decrease in inventories as per cost accounts	3,90,12,500		
Decrease in inventories as per financial accounts	3,82,06,430	8,06,070	<u>53,37,200</u>
<b>Profit as per Cost Accounts</b>			<b>20,10,500</b>

## MTP\_Final\_Syllabus-2016\_June 2019\_Set -1

3. (a)

ABC LTD. has the following Balance Sheet as on March 31, 2018 and March 31, 2017.

(Amount in Lakh)

Year ended March 31	2018	2017
<b>SOURCES OF FUNDS:</b>		
Shareholders' Fund	2,972	1,886
Loan Funds	4,644	4,060
	7,616	5,946
<b>APPLICATIONS OF FUNDS:</b>		
Fixed Assets	4,279	3,600
Cash and Bank	707	684
Debtors	1,914	1,522
Stock	3,560	3,008
Other Current Assets	2,000	1,805
Less: Current Liabilities	(4,844)	(4,673)
	7,616	5,946

The Income statement of ABC LTD. for the year that ended is as follows:

(Amount in Lakh)

Year ended March 31	2018	2017
Sales	26,718	16,778
Less: Cost of Goods Sold	25,152	15,173
Gross Profit	1,566	1,605
Less: Selling, General & Administrative expenses	1,242	782
Earnings before Interest & Tax (EBIT)	324	823
Less: Interest Expenses	256	246
Profit before Tax (PBT)	68	577
Less: Tax	28	230
Profit After Tax	40	347

Required:

Calculate for the year 2017-18:

(a) Inventory Turnover Ratio

(b) Return on Net Worth

(c) ROI

(d) ROE

(e) Profitability Ratios

(f) Give brief comments on the financial position of company (1+1+1+2+3+2)=10

(b) What is meant by 'Normal Price' with reference to 'Related Party Transaction' in CRA 1? State the basis adopted to determine 'Normal Price'. 6

Answer:

3. (a)

ABC Ltd

**Various Ratios for the year 2017-18**

(a) Inventory Turnover Ratio = Cost of Goods Sold / Average Inventory = 25,152/3,284 = 7.66

(b) Return on Net Worth = Profit after Tax / Net Worth = (40/2,972) x 100 = 1.35%

(c) ROI = Net Profit before Interest but after Tax / Average Share Holders' Fund = (296/6,781) x 100 = 4.37%

\*NP before Interest and tax = 256 + 40 = 296

\*\* Average capital employed = (7,616 + 5,946)/2 = 6,781

(d) ROE = (Profit after Tax available to equity Share Holders / Average Share Holders' Funds) x 100 = (40/2429) x 100 = 1.65 %

# MTP\_Final\_Syllabus-2016\_June 2019\_Set -1

---

(e) Profitability Ratios:

Gross Profit Ratio =  $(1,566/26,718) \times 100 = 5.86\%$

Operating Profit Ratio =  $[(68+256) / 26,718] \times 100 = 1.21\%$

Net Profit Ratio =  $(40/26,718) \times 100 = 0.15\%$ .

(f) **Comment:** There is a substantial decline in Profitability in the current Year from ₹ 823 Lakhs of previous year to ₹ 324 Lakhs. This is mainly due to huge increase in the operating expenses. There has been substantial increase in the Interest charges also. During the year 2017-18 both fixed financial expenses and operating expenses have increased. During current year both operating and financial leverages have been adversely affected. It can be seen that the company is suffering from a liquidity crisis during the year.

3. (b) As per Para 24 (b) of the CRA 1, — Normal Price means price charged for comparable and similar products in the ordinary course of trade and commerce where the price charged is the sole consideration of sale and such sale is not made to a related party. Normal Price can be construed to be a price at which two unrelated and non-desperate parties would agree to a transaction and where such transaction is not clouded due to the proximity of the parties to the transaction and is free from influence through the parties may have shared interest.

The basis adopted to determine Normal Price, shall be classified as under:

- (i) Comparable Uncontrolled Price method
- (ii) Resale Price method
- (iii) Cost-plus method
- (iv) Profit Split method
- (v) Transactional Net Margin method, or
- (vi) Any other method, to be specified.

4. (a) **What is XBRL and what are the steps to be followed to file the Cost Audit Reports in XBRL Format?**

(b) **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 ₹ 51000. The balance units were sold as scrap for ₹ 5 per unit.**

**Calculate Material Quality Variance, Material Usage Variance and Scrap Variance. [8+8]**

**Answer:**

4. (a) XBRL (eXtensible Business Reporting Language) is a language based on XML (Extensible Markup Language) family of languages. It is an open standards-based reporting system that is built to accommodate the electronic preparation and exchange of business reports around the world using internet as a medium. It has been defined specifically to meet the requirements of business and financial information.

**The following steps are to be followed in sequence to file the Cost Audit Reports in XBRL Format:**

- (i) Mapping the individual cost elements of the Company to the elements of costing taxonomy.
- (ii) Populating relevant data in the soft ware/ filing tool.

## MTP\_Final\_Syllabus-2016\_June 2019\_Set -1

- (iii) Creating instance document.
- (iv) Validating the instance document with the validation tool of MCA.
- (v) Use available tool to convert the instance document to a human readable format and check correctness of data.
- (vi) Attaching instance document to the e-form and filing on MCA portal.

4. (b) Quality control cost is the cost of resources used for quality control procedures.

Standard Material Cost:

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)	Std Cost per unit	₹ 73.00
Actual Material cost :		
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

$$\begin{aligned} \text{Material Quality Variance} &= \text{Actual Material cost} - \text{Actual Quantity} \times \text{Std Rate} \\ &= ₹ 14,68,500 - (19,500 \times 73) = 14,68,500 - 14,23,500 \\ &= ₹ 45,000 \text{ (A)} \end{aligned}$$

$$\begin{aligned} \text{Material Usage Variance} &= \text{Actual Quantity} \times \text{Std Rate} - \text{Std Quantity} \times \text{Std Rate} \\ &= \text{Std Rate} (\text{Actual Quantity} - \text{Std Quantity}) = 60 (24,000 \\ &\quad - 19,500 \times 6/5) \\ &= 60 (24,000 - 23,400) = 60 \times 600 = ₹ 36,000 \text{ (A)} \end{aligned}$$

For Scrap Variance

Actual scrap = ₹ 22,500

Scrap value as per standard =  $19,500 \times (1/5) \times 5 = 19,500$

Scrap Variance = ₹ (22,500 - 19,500) = ₹ 3,000 (F)

Material cost/unit = ₹ 72,000/1200 = ₹ 60/unit.

5. (a) Write a short note on Corporate Development Audit.

(b) What is Productivity Audit? What are the ratios are used in measuring productive efficiency of the resources deployed and utilised? [6 + 10]

Answer:

5. (a) A Corporate Development Audit is an independent objective study of an organization's capabilities. It aims at identifying strengths and weaknesses and moving toward state-of-the-art performance. A Corporate Development Audit gives a comprehensive picture of the status of corporate development effectiveness and highlights developmental needs. It is a comprehensive task to assist the corporate management in various aspects of development through a process of systematic review and evaluation of long-term strategies of the company.

Corporate Development Audit assures that –

- i) The various factors and forces constituting a corporate enterprise are the right kind and quality.
- ii) Communication remains the key to the functioning of an enterprise.

- iii) The pattern of departmentalization in an enterprise adopted in the past and proposed for the future for dealing with multidirectional responsibilities is fully responsive to circumstances and business environment.
- iv) The personnel problems are handled appropriately considering the overall objectives of development of the corporate enterprise.
- v) The responsibilities of planning, coordination, motivation and control at functional management levels are discharged in proper spirit.

Large scale corporate enterprises offer opportunities to the conduct of Corporate Development Audit. Contrary to other forms of audit – statutory or non-statutory (viz. Financial Audit, Cost Audit, Efficiency Audit, Propriety Audit, etc.) Corporate Development Audit plays a vital role not only tying up the loose ends, but also to forge a link in the knowledge that emanates from different quarters and on the basis of different types of experiences in dealing with various types of problems.

5. (b) The Productivity Audit is basically an analysis of the productivity of the resources deployed by any organization. It is generally done to generate information about the status of productivity in the organization for the purpose of determining the scale of efficiency and effectiveness of 'resource utilization'. The term 'resources' here would include not only "money" but also "men", "machines", "materials" and "methods".

In other words, the objectives of Productivity Audit are – (a) to attain optimum result, and (b) to improve on the benchmarks.

This audit would generally comprise –

- (i) Comparison of expected returns on utilization of the resources vis-à-vis the actual returns;
- (ii) Comparison of optimum returns on utilization of the resources vis-à-vis the actual returns; and
- (iii) The steps taken to improve benchmarks of returns and the utilization.

**The following ratios are generally used in measuring productive efficiency of the resources deployed and utilized:**

Resources Deployment

- (i) Capital employed per capita
- (ii) Capital employed per unit of product
- (iii) Gross profit to capital employed
- (iv) Net profit to capital employed
- (v) Debt equity ratio
- (vi) Net worth and long-term debts to gross fixed assets
- (vii) Net worth and long-term debts to net fixed assets
- (viii) Debts to fixed loans
- (ix) Debts to floating loans
- (x) Current assets to current liabilities
- (xi) Net working capital
- (xii) Total inventory to capital employed.

6. (a) **What is Internal Audit? Discuss about the necessity of Internal Audit.**

(b) **What is the role of CMA in Internal Audit?**

**[6 + 10]**

**Answer:**

6. (a) Internal Audit is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

The role of internal audit is to provide independent assurance that an organization's risk management, governance, and internal control processes are operating effectively. Internal audit is conducted objectively and designed to improve and mature an organization's business practices.

## **Necessity of Internal Audit**

The necessity of internal audit is as follows:

- i) Internal Audit assists management to improve internal controls by identifying weaknesses in systems and provides an opportunity to correct those weaknesses. Internal auditors deal with issues that are important to the continued existence and prosperity of any organisation.
  - ii) It helps to detect errors and frauds and provides suggestions to improve them which help the management to take corrective action.
  - iii) It detects the misuse of resources in time which helps to reduce unnecessary expenses.
  - iv) It increases the morale of honest staff because evaluation of performance of any staffs will be made at any time.
  - v) Internal audit checks the books of accounts, detects errors and frauds and helps in its correction which makes the act of External/Statutory Auditor easier.
  - vi) It helps capacity building for organizational effectiveness.
6. (b) Presently, the role of Internal Audit has become more critical. The backdrop and changing business scenario and the role metamorphosed as technology have erased global barriers. Customer expectations have increased and compliance demands are growing both in terms of quantity and complexity. The Enterprise Risk Management is emerging as the key element in Corporate Management.

The expectations of the Board from Internal Auditors are now to assist the Board in identification, monitoring and management of business risks and also to offer and provide insight, advice and assurance on enterprise risks. The Internal Auditors should also inform directors' about the tone of the organization-culture, ethics, performance and continuously evaluate the efficiency and effectiveness of operations. They should also check compliance with laws and regulations and authenticate the reliability of financial and management reporting. Internal Auditors has the added role of safeguarding the assets of the company. They should evaluate performance management and control systems and act as an advisor to the Management. The role of effective Cost Management involves in waste reduction and enhancing productivity and process improvement.

The Internal Audit must be synchronized to the expectations of the Board. It must develop an internal audit strategy that is linked with the organization's strategic plan with a focus on optimizing risks, costs, and value. It must develop dynamic internal audit plans. The communication must be done frequently with key stakeholders on their needs, expectations, satisfaction with the internal audit. It should leverage technology to optimize audit operations and assist management in developing and maintaining a comprehensive performance management framework. It should support and facilitate business process improvement and re-engineering and provide active support in furthering good Corporate Governance. CMAs have a colossal role to play as they have a unique blend of core competencies in accounting, management and strategy. CMAs can apply their forward looking insights across the organization to manage risks, reduce costs and create new opportunities, preserve and enhance value.

## MTP\_Final\_Syllabus-2016\_June 2019\_Set -1

CMA's possess the expertise to evaluate the operational efficiency, productivity and profitability, wastages, losses, inefficiency. They can apply their knowhow in judging efficiency of management of resources, capacity utilization, channelling resources into productive channels, standards of efficiency of performance, production processes and performance of respective units. Efficiency of business processes, Enterprise Performance Management, Business risks. Efficiency of Supply Chains, Efficiency of Utilities / Energy Consumption, Sustainability of Business is critical drivers to keep the business focused on priority areas.

The perspective of CMA's has changed in the present era of mergers & acquisitions, new product development and also to climate change and sustainability. The financial perspective, customer perspective, operational perspective and people perspective all can be aligned to meet the goal of the business.

**7. (a) (i) What is "Waste Multiplier" in Textile Costing?**

**(ii) The following are the process-wise input and output in a Spinning Mill –**

<b>Blow room :</b>	<b>Cotton processed</b>	<b>4672563 kgs</b>
	<b>Laps produced</b>	<b>4258274 kgs.</b>
<b>Carding :</b>	<b>Laps processed</b>	<b>4274362 kgs.</b>
	<b>Silvers produced</b>	<b>3976420 kgs.</b>
<b>Draw frames :</b>	<b>Silvers processed</b>	<b>3948241 kgs.</b>
	<b>Silvers drawn</b>	<b>3901810 kgs.</b>
<b>Roving (Simplex) :</b>	<b>Drawn silvers processed</b>	<b>3874125 kgs.</b>
	<b>Transferred to Ring frame</b>	<b>3831510 kgs.</b>
<b>Ring frame :</b>	<b>Silvers used</b>	<b>3911645 kgs.</b>
	<b>Finished Yarn produced</b>	<b>3641741 kgs.</b>
<b>Reeling and Winding :</b>	<b>Yarn wound</b>	<b>3635420 kgs.</b>
	<b>Salable Yarn produced</b>	<b>3580889 kgs.</b>

Calculate the process wise Waste Multiplier factors.

[4 + 6]

**(b) There was a strike from 13.09.2017 to 16.11.2017 in a company of which you were the Cost Auditor for the year ending 31.03.2018. Although the company began working from 17.11.2017, production could effectively begin only from 5.12.2017. The expenses incurred during the year ended 31.03.2018 were:**

<b>Particulars</b>	<b>(₹ in lakhs)</b>
<b>Salaries &amp; Wages (direct)</b>	<b>450</b>
<b>Salaries &amp; Wages (indirect)</b>	<b>300</b>
<b>Power (variable)</b>	<b>180</b>
<b>Depreciation</b>	<b>270</b>
<b>Other Fixed Expenses</b>	<b>360</b>

Detailed examination of the records reveals that of the above, the following relate to the period 13.09.2017 to 16.11.2017:

<b>Particulars</b>	<b>(₹ in lakhs)</b>
<b>Salaries &amp; Wages (indirect)</b>	<b>105</b>
<b>Depreciation</b>	<b>90</b>
<b>Other Fixed Expenses</b>	<b>135</b>

Calculate the amount which in your opinion should be treated as abnormal for exclusion from the product costs.

6

## MTP\_Final\_Syllabus-2016\_June 2019\_Set -1

**Answer:**

7. (a) (i) "Waste multiplier" is the quantity of output from any process, which will be needed to get one unit of final output. To arrive waste multiplier processing cost per kg of output is worked out. These costs are then aggregated to arrive at total yarn cost. This is done by using a factor known as Waste multiplier.

A Spinning unit of Cotton Textile Industry has a set of processing departments like Mixing and Blow Room, Carding, Drawing, Combing, Fly Frames and Ring Frames. Actually spinning unit comes under continuous process industry. Mixing and Blow Room are the starting point when the raw material cotton enters and comes out as yarn in the Ring Frame section. Obviously like every processing industry in spinning mills certain amount of wastage is emerging out of production in each and every department. It is segregated as usable waste and saleable waste apart from invisible loss. While the usable waste and saleable waste can be measured physically the invisible loss is found out from the input and output of raw materials after considering due weightage of usable and saleable waste. The actual waste which is extracted from the machine process depends upon the impurities in the cotton. The production process involving wastage has a routine or cycle.

7. (a) (ii)

Process	Input (kgs)	Output (kgs)	Loss (%)	Output (%)	Waste Multiplier
Total Consumption				100.00	1.3161
Blowroom :	4672563 kgs.	4258274 kgs.	8.87	91.13	1.1994
Carding :	4274362 kgs.	3976420 kgs.	6.97	84.78	1.1158
Draw frames :	3948241 kgs.	3901810 kgs.	1.18	83.78	1.1026
Roving (Simplex) :	3874125 kgs.	3831510 kgs.	1.10	82.86	1.0905
Ring frame :	3911645 kgs.	3641741 kgs.	6.90	77.14	1.0153
Reeling and Winding:	3635420 kgs.	3580889 kgs.	1.50	75.98	1.0000

Loss Percentage = (Input-output)/input × 100

7. (b) Calculation of Fixed expenses incurred during the period 17.11.2017 to 04.12.2017

Particulars	₹ in lakhs
Total expenses 2017 - 18	1,560
Less: Variable expenses (Electricity)	180
Fixed expenses (2017 - 18)	1,380
Less: Fixed expenses during the strike period	330
Fixed expenses during non-strike period	1,050

Since the strike period was for 65 days, the non-strike period is 300 days. Hence, Fixed expenses attributed to 18 days, i.e., 17.11.2017 to 4.12.2017 is 6% of ₹ 1,050 lakhs = ₹ 63 lakhs.

Therefore, Expenses incurred during 13.9.17 to 16.11.17	₹ 330 lakhs
For expenses incurred during 17.11.2017 to 04.12.2017	₹ 63 lakhs
<b>Total</b>	<b>₹ 393 lakhs</b>

Hence, ₹ 393 lakhs is to be treated as abnormal cost and should be excluded from the product cost.

# MTP\_Final\_Syllabus-2016\_June 2019\_Set -1

---

8. Answer any four.

4x4=16

- (a) How value Chain activity can have an impact in performance analysis?
- (b) What is the Role of Management with regard to Internal Control?
- (c) Briefly state the disclosure and transparency requirements for Corporate Governance.
- (d) Distinguish between Management Audit and Internal Audit.
- (e) Write a short note on Profitability Analysis.

Answer:

8. (a) **Value Chain** — many company attempts to gain competitive advantage by appropriately linking its own activities with those of the suppliers, channels or customers. Vertical-integration, quality controls on inputs from suppliers, total quality management strategies, controlling distributors' performance through training/financing etc., collaborative arrangements etc. are some of the ways in which company's own activities are beneficially linked to other organizations. This provides an avenue for reporting under performance analysis report. What has been the cost of such coordinating strategies and how much of competitive advantage of the company has improved or strengthened at present level? If such linkages with other companies are established as a matter policy, every year, then performance as to the cost efficiency in such coordinating/cooperating linkages can be an area for appraisal for the Cost Auditor.
8. (b) The role of Management with regard to internal Control can be summarized as under-
- (i) Creation of system: Management is responsible for maintaining an adequate accounting system incorporating various internal Controls to the extent appropriate to the size and nature of the Business. The Management is vested with the responsibility of carrying on the business, safeguarding its assets and recording the transactions in the books of account and other records.
  - (ii) Review of system: The system installed, should be reviewed by the Management to ascertain, whether- (a) The prescribed Management policies are being properly interpreted by the employees and are faithfully implemented, (b) The prescribed procedures need a revision due to changed circumstances or whether they have become obsolete or cumbersome, and (c) Effective and corrective measures are taken promptly when the system appears to breakdown.
  - (iii) Internal Audit: it is desirable that the Management also installs an internal audit System as an independent function to check, amongst other things, the actual operation of the Internal Control System and report any deviations or non-compliances.
8. (c) The company should ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the company.
- (i) Information should be prepared and disclosed in accordance with the prescribed standards of accounting, financial and non-financial disclosure.
  - (ii) Channels for disseminating information should provide for equal, timely and cost efficient access to relevant information by users.
  - (iii) The company should maintain minutes of the meeting explicitly recording dissenting opinions, if any.
  - (iv) The company should implement the prescribed accounting standards in letter and spirit in the preparation of financial statements taking into consideration the interest of all stakeholders and should also ensure that the annual audit is conducted by an independent, competent and qualified auditor.

8. (d)

Aspects	Management Audit	Internal Audit
Definition	Management Audit is – (a) the systematic independent appraisal activity, (b) within an organisation, (c) for a review of the Management's efficiency, (d) in its decision-making function.	Function of internal control with the objective of determining whether other internal controls are well designed and properly operated.
Relationship to Internal Control	It is not a part of Internal Control. It is over and above the regular internal control system.	This operates as a part of Internal Control System.
Objectives	It is concerned with appraising - <ul style="list-style-type: none"> <li>• Management's accomplishment of organizational objectives,</li> <li>• Management functions of planning, organizing, directing, and controlling, and</li> <li>• Adequacy of Management's decisions and action in moving towards its objectives.</li> </ul>	<ul style="list-style-type: none"> <li>• To determine whether internal controls are well designed and properly operated, and</li> <li>• To assist all members of Management in the objective of discharging of their responsibilities by reviewing activities and procedures.</li> </ul>
Function	Constructive Function, i.e. to provide suggestions for improvement.	Protective Function, i.e. to safeguard the assets of the Enterprise.
Areas	All aspects of managerial decision making are analysed, to see whether they are in tune with Management policies, objectives and goals.	The traditional field of Internal Auditors is restricted to financial accounting and internal control.
Aspect	Qualitative aspects of decision making are analysed.	Internal Audit Function focuses more on quantitative aspects when compared to Management Audit.

8. (e) Profitability analysis is a component of resource planning that allows administrators to forecast the profitability of a proposal or optimize the profitability of an existing project. Profitability analysis can anticipate sales and profit potential specific to aspects of the market such as customer age groups, geographic regions, or product types.

Profitability analysis helps an enterprise to:

- (i) Identify the most and least profitable products or services.
- (ii) Discover which sources of information offer the most reliable facts.
- (iii) Optimize responses to changing customer needs.
- (iv) Evolve the product mix to maximize profits in the medium and long term.
- (v) Isolate and remedy the causes of decreasing profit margins.

Profitability Ratio Analysis forms part of Part D of the Annexure to Cost Audit Report.