

Paper-17 - COST AUDIT & OPERATIONAL AUDIT

Time allowed-3hrs

Full Marks: 100

**SECTION I (50 Marks)
(Cost Audit)**

Answer Question No. 1 (carrying 14 marks) which is compulsory and answer any two (carrying 18 marks each) from the rest in this Section.

Working Notes should form part of the answer.

“Wherever necessary, suitable assumptions should be made and indicated in answer by the candidates”

1.

- a) Choose the most correct answer among four alternative statements : [5]
- i) Cost Auditor should inform to the Central Government in Form 23D of his appointment within :
- A. 90 days from receiving formal letter from the company.
 - B. 30 days of the Board meeting in which such appointment is made or within a period of 180 days of the commencement of the financial year, whichever is earlier.
 - C. 90 days from the date of commencing of the current financial year.
 - D. 45 days from the date of commencing of the current financial year.
- ii) Every Cost Auditor shall forward his report :
- A. To the Central Government.
 - B. To the Board of Directors of the Company.
 - C. To the Shareholder of the Company.
 - D. To the Creditors of the Company.
- iii) The structuring of Cost Audit includes
- A. Audit Programmes
 - B. Audit working papers
 - C. Checking including test checking
 - D. All of the above
- iv) The role of Cost Auditor in respect of non-moving stock is to review
- A. The causes explained by the company for non-movement of the items.
 - B. How the company deals with the non-moving stock.
 - C. The policy of the company regarding determination on non-moving items.
 - D. All of the above.
- v) The significance of Form CRA -1 is –
- A. Maintenance of Cost Records of the Company.
 - B. Form of intimation of appointment of Cost Auditor by the Company to Central Government.
 - C. Form of Cost Audit Report.
 - D. Form of filing Cost Audit Report with the Central Government.

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- b) State with reasons whether the following statements are “True” or “False”. [5]
- i) The shareholder of the company has no statutory right to demand a copy of cost Audit Report.
 - ii) Companies (Cost Records and Audit) Rules, 2014 is applicable to a company which is generating electricity for captive use.
 - iii) Detection of errors and fraud is one of the social objectives of Cost Audit.
 - iv) Two companies simply having a common Director shall not be deemed as ‘Related Party’.
 - v) The Cost Auditor of a company is appointed by the Board of Directors subject to the intimation to the Central Government.
- c) Fill in the blanks in the following sentences. [4×1=4]
- i) Cost Audit was initially introduced in the year -----.
 - ii) Each Cost Accounting Record Rule is given a ----- number and date of publication in the Gazette.
 - iii) Rate per unit for each product with CETA heading separately under Annexure-2 of Part B of the Cost Audit Report is to be furnished for current year and -----.
 - iv) CERA (Central Excise Revenue Audit) is conducted by the organization of -----.

Answer:

- a)
- i) B
 - ii) B
 - iii) D
 - iv) D
 - v) A
- b)
- i) **True**, the shareholder of the company has no statutory right to demand a copy of Cost Audit Report since it contains confidential data of the company.
 - ii) **False**, The Companies (Cost Records and Audit) Rules, 2014 is applicable to a company which is engaged in generation, transmission, distribution and supply of electricity regulated by the relevant regulatory body or authority under the Electricity Act, 2003 (36 of 2003), other than for captive generation.
 - iii) **False**, it can be termed as a general objective of cost audit.
 - iv) **False**, it will fall under the clause of common control and therefore they will be treated as if they are related party.
 - v) **True**, the Cost Auditor of a company is appointed by the Board of Directors subject to the intimation to the Central Government.
- c)
- i) 1956
 - ii) GSR
 - iii) Previous year
 - iv) Comptroller and Auditor General

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2.

- a) Describe the classification of costs according to the nature of expense and also according to the functions or activities as per CAS-1. [3+5]
- b) You are the Cost Auditor of MP Jute Mills Ltd. for the year ended March 31, 2015. The company had a strike from 15.9.2014. Although the company resumed working from 18.11.2014, normal production was achieved only from 12.12.2014. The expenses incurred during the year ended March 31, 2015 were:

	(Amount in ₹ lakh)
Salaries and wages (Direct)	450
Salaries and wages (Indirect)	220
Power (Variable)	160
Depreciation	140
Other fixed expenses	260

Detailed examination of the records revealed that of the above, the following relate to the period 15.9.2014 to 17.11.2014:

	(Amount in ₹ lakh)
Salaries & wages (Indirect)	80
Depreciation (Non- productive)	60
Other fixed expenses	110

As a Cost Auditor you are requested to calculate abnormal cost which will be excluded from the product cost. [10]

Answer:

- a) Classification of cost is the arrangement of items of costs in logical groups having regard to their nature or purpose. According to CAS-1 —
- **Classification of costs on the basis of Nature of expense:**
- (i) **Material Cost:** it is the cost of material of any nature used for the purpose of production of a product or a service. It includes cost of procurement, freight inwards, taxes & duties, insurance etc directly attributable to the acquisition. Trade discounts, rebates, duty drawbacks, refunds on account of modvat, cenvat, sales tax and other similar items are deducted in determining the costs of material.
- (ii) **Labour Cost:** It means the payment made to the employees, permanent or temporary, for their services. It includes salaries and wages paid to permanent employees, temporary employees and also to employees of the contractor. Here, salaries & wages include all fringe benefits like Provident Fund contribution, gratuity, ESI, overtime, incentives, bonus, ex-gratia, leave encashment, wages for holidays and idle time etc.
- (iii) **Expenses:** These are other than material cost or labour cost which are involved in an activity. Expenditure on account of utilities, payment for bought out services, job processing charges etc. can be termed as expenses.

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➤ **Classification of costs on the basis of the functions or activities:**

- (i) **Production Cost:** it is the cost of all items involved in the production of a product or service. It includes all direct costs and all indirect costs related to the production. Production overhead is the indirect costs involved in the production process. Examples of Production overhead — Salaries for staff for production planning, technical supervision, factory administration etc., expenses for stores management etc.
- (ii) **Administration costs:** These are expenses incurred for general management of an organization. These are in the nature of indirect costs and are also termed as administrative overhead. Examples of administrative overhead — Salaries of administrative and accounts staff, general office expenses like rent, lighting, rates and taxes, telephone, stationery, postage etc.
- (iii) **Selling costs:** These are indirect costs related to selling of products or services and include all indirect cost in sales management for the organization. It includes all costs relating to regular sales and sales promotion activities. Examples — Salaries, commission and traveling expenses for sales personnel, after sales service cost etc.
- (iv) **Distribution Costs:** These are the cost incurred in handling a product from the time it is completed in the works until it reaches the ultimate consumer. These costs incurred for distribution of product to customers. Examples — transportation cost, cost of delivering the products to customers etc.
- (v) **Research & Development Costs:** These are the cost for undertaking research to improve quality of a present product or improve process of manufacture, develop a new product, market research etc and commercialization thereof. Research Cost comprises the cost of development of new product and manufacturing process; improvement of existing products, process and equipment; finding new uses for known products; solving technical problem arising in manufacture and application of products etc. Development cost includes the cost incurred for commercialization / implementation of research findings.

b)

MP Jute Mills Ltd.

Calculation of fixed expenses incurred during the period: 18.11.2014 to 11.12.2014:

(Amount in ₹ Lakh)

Total Expenses for 2014-2015	1,230
Less: Variable Expenses (Power)	<u>160</u>
Fixed Expenses for 2014-15	1,070
Less: Fixed expenses during strike period	<u>250</u>
Fixed Expenses during non strike period	<u>820</u>

Since strike period was for 64 days (15.9.2014 to 17.11.2014)

The non-strike period is 301 days.

Hence fixed expenses attributed to 24 days i.e.

18.11.2014 to 11.12.2014 is 7.97% ($24 \div 301 \times 100$) of ₹ 820 lakh = ₹ 65.35 lakh

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(Amount in ₹ Lakh)

Expenses incurred during the period of 15.9.2014 to 17.11.2014	240.00
Expenses incurred during the period of 18.11.2014 to 11.12.2014	<u>65.35</u>
Total	<u>305.35</u>

Hence ₹ 305.35 lakh is to be treated as Abnormal Cost and should be excluded from Product Cost.

3.

a) Define Cost Object according to CAS-7. Also state the disclosure requirements for employee costs as per CAS-7. [1+7]

b) Define Cost of Production for Captive Consumption under CAS-4. [4]

c) Manufacturer's specification capacity for a machine per hour = 750 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 = 1 hour.

Production based on sales expectancy during last five years = 38.10, 44, 32.91, 39.25, and 38.30 lacs units.

Actual production during the year = 38.20 lacs units.

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

[6]

Answer:

a) **Cost Object (as per CAS-7):** This includes a product, service, cost centre, activity, sub-activity, project, contract, customer or distribution channel or any other unit in relation to which costs are finally ascertained.

The Disclosure Requirements for Employee Costs as per CAS-7:

(i) The cost statements shall disclose the following:

1. Employee cost attributable to capital works or jobs in the nature of deferred revenue expenditure indicating the method followed in determining the cost of such capital work.
2. Separation costs payable to employees.
3. Any abnormal cost excluded from Employee cost.
4. Penalties and damages paid etc excluded from Employee cost.
5. Any Subsidy, Grant, Incentive and any such payment reduced from Employee cost.

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6. The Employee cost paid to related parties.
7. Employee cost incurred in foreign exchange.
- (ii) Any change in the cost accounting principles and methods applied for the measurement and assignment of the Employee Cost during the period covered by the cost statement which has a material effect on the Employee Cost. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.
- (iii) Disclosures shall be made only where material, significant and quantifiable.
- (iv) Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.
- b) It is defined in Para 4.1 that Cost of Production shall consist of Material Consumed, Direct Wages and Salaries, Direct Expenses, Works Overheads, Quality Control Cost, Research and Development Cost, Packing Cost, Administration overheads relating to production. To arrive at cost of production of goods dispatched for Captive consumption, adjustment for stock of work-in-process, finished goods, recoveries for sale of scrap, wastage etc. shall be made. In other words, "Cost of Production" for captive consumption shall include all direct expenses (including packing cost and research & development cost), production overheads and proportionate share of administrative overheads.

c) Installed capacity for the machine = $365 \times 8 \times 3 \times 750 = 65.70$ lacs units

Available capacity = $(365 - 52 - 8) \times (8 - 1) \times 3 \times 750 = 305 \times 7 \times 3 \times 750 = 48.04$ lacs units

Normal capacity = $(38.10 + 39.25 + 38.30)$ lacs units/3 = 38.55 lacs units.

Actual production = 38.20 lacs units

Actual capacity utilization = 38.20 lacs units
 = $(38.20/65.70)$ lacs units $\times 100$.
 = 58.14%

Idle capacity = $(65.70 - 38.20)$ lacs units
 = 27.50 lacs units
 = $27.50/65.70 \times 100 = 41.86\%$

Abnormal idle capacity = $(38.55 - 38.20)$ lacs units = 0.35 lacs units

4.

- a) Following data is available for a company relating to the cost of production of a product subjected to Cost Audit. Prepare the Export Profitability Statement to be included in the Annexure to the Cost of Production of 20,000 units.

	₹
Sales (local) 18,000 units	4,05,000
Sales (export) 2,000 units	40,000
Material consumed 40 tonnes @ ₹ 5 kg.	2,00,000
Imported Component @ ₹ 3/unit	60,000
Direct Labour	20,000
Factory Overhead	30,000
Administrative Overhead	10,000

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Freight & Packing (local sales)	9,000
Packing for export	4,000
Handling at port	1,000
Opening Work-in-progress	20,000
Closing Work-in-progress	10,000

Additional Information:

(i) Export incentive of 10% on F.O.B is receivables.

(ii) Draw Back on duty paid on raw materials and components available on export is ₹ 5000. [10]

b) As a cost auditor what will you verify on the area of 'overheads and indirect expenditure'? [4]

c) What as a Cost Auditor, will you verify in the area of work-in-progress? [4]

Answer

a) Taking into consideration the requirements under provisions of Cost Audit (Report) Rules, like showing separately local and export sales, with details like quantity, net realization, price per unit, packing charges etc., Profitability Statements have been prepared as follows:

Statement of Cost of Production

Production : 20,000 units	Total cost (₹)	Per unit cost (₹)
Direct Materials (40,000 Kgs. @ ₹ 5 per Kg)	2,00,000	10.00
Imported components(20,000 units @ ₹ 3/unit)	60,000	3.00
Direct Labour	20,000	1.00
Prime Cost	2,80,000	14.00
Factory Overhead	30,000	1.50
Opening WIP	20,000	1.00
	3,30,000	16.50
Less: Closing WIP	10,000	0.50
Work Cost	3,20,000	16.00
Administrative Overhead	10,000	0.50
Cost of Production	3,30,000	16.50

Statement of Cost and Profit on Export Sales

Export Sales : 2,000 units	Total cost (₹)	Per unit cost (₹)
Cost of production	33,000	16.50
Export packing	4,000	2.00
Handling at port	1,000	0.50
(A) Cost of Sales	38,000	19.00
Export Sales realisation	40,000	20.00
Export incentive @ 10% of F.O.B	4,000	2.00
Duty Drawback on components	5,000	2.50
(B) Total realization	49,000	24.50
Profit on Export (B) – (A)	11,000	5.50

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- b)** A Cost Auditor must verify the following aspects in the area of 'overheads and indirect expenditure'.
- (i) That allocation of overheads are as per CAS 3 which deals with overheads;
 - (ii) That allocation of indirect expenditure over production, sales, and distribution is logical and correct;
 - (iii) That compared with the value of production in a production shop, the overhead charges are not excessive;
 - (iv) That the actual indirect expenditure does not exceed budgets or standard expenditure significantly and that any variations are satisfactorily explained and accounted for;
 - (v) That the relation of indirect expenditure in keeping with the load on individual production shop is appropriate;
 - (vi) correctness of appropriate allocation of overhead expenditure (both production and sales) will be certified by Cost Auditor;
 - (vii) That allocation of overheads between finished products and unfinished products is in accordance with principles as per CAS 3.
- c)** The Cost Auditor should verify the following area of work-in-progress :
- (i) That the work-in-progress has been physically verified and it agrees with the quantity shown in job-cards of uncompleted work.
 - (ii) 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 of job cost cards or process cost sheet.
 - (iii) 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.
 - (iv) That the volume and value of work-in-progress is not disproportionate as compared with finished production.

SECTION II (50 Marks) (Operational Audit)

**Answer Question No. 5 (carrying 14 marks) which is compulsory and
Answer any two (carrying 18 marks each) from the rest in this Section.**

5.

- c) State whether the following statements are 'TRUE' or 'FALSE' with justification for your answer. [5]**
- i) The Consumer Service Audit critically examines the outstanding payment of consumers.**
 - ii) The Companies Act, 2013 had introduced section 277 regarding Constitution of Audit Committees.**
 - iii) 'Position Analysis' is one of the techniques used by the Management Auditor for evaluation of corporate image.**
 - iv) Operational Audit is termed as Micro Level Management Audit.**

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- v) **The Statutory Auditor (which term includes Cost Auditor) can only be an invitee for their comments and not a member of the Audit Committee.**
- d) **Fill in the blanks in the following sentences by using appropriate word(s)/phrase(s) : [5]**
- i)is needed to create corporate culture of transparency.
 - ii) **Management Audit requiresapproach.**
 - iii) in banks traditionally implies transaction audit.
 - iv) **Activity based costing is the extended application ofto activity centres.**
 - v) **Theis the highest body of the structure of the WTO.**
- e) **What do the following abbreviations stand for? [4]**
- i) **OECD**
 - ii) **IAASB**
 - iii) **TPRB**
 - iv) **TRIPS**

Answer:

- a)
- i) False: Consumer Service Audit is concerned with appraisal of management's responsibility towards customer for providing quality goods at right time, right place and right price.
 - ii) False: the relevant section for constitution of Audit Committee under Companies Act, 2013 is Section 177.
 - iii) True: Brand positioning is used to evaluate corporate image.
 - iv) True: Operational Audit is termed as Micro Level Management Audit.
 - v) True: The Statutory Auditor (which term includes Cost Auditor) can only be an invitee and not a member of the Audit Committee.
- b)
- i) Corporate Governance
 - ii) Inter-disciplinary
 - iii) Bank Audit
 - iv) Value Engineering.
 - v) Ministerial Conference.
- b)
- i) OECD – Organization for Economic Co-operation and Development.
 - ii) IAASB- International Auditing & Assurance Standards Board.
 - iii) TPRB : Trade Policy Review Body
 - iv) TRIPS: Trade-Related Aspects of Intellectual Property Rights.

6.

- a) **Explain whether the following activities amount to professional misconduct on the part of a Cost Accountant: [2x3=6]**
- i) **CMA Pankaj, a Cost Accountant in practice published a book and gave his personal as an author. These details also mentioned his professional experiences and his association as partner with SKR and Co., a firm of Cost Accountants.**
 - ii) **M/s. A.P. Shah & Associates, a firm of Cost Accountants in practice, develops a website "shah.com". The colour chosen for website was very bright yellow where the names of the partners of the firm along with their various professional attainments and the major clients were to be displayed on the website.**

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iii) **CMA Nikhil a Cost Accountant in practice takes up the appointment as Managing Director of Nagar LTD., a public limited company.**

b) **State the functions of the Audit Committee.** [6]

c) **What do you understand by 'Corporate Image' and 'Branding'? What are the possible approaches to evaluate Corporate Image?** [3+3=6]

Answer:

a) (i) A Cost Accountant in practice shall be deemed to be guilty of professional misconduct, if he solicits clients or professional work either directly or indirectly, by circular, advertisement, personal communication or interview or by any other means.

CMA, Amit being a Cost Accountant in practice has committed a professional misconduct by mentioning that at present he is a partner of M/s SKR & Associates, a firm of Cost Accountants (Clause 6 of part I of First Schedule to the Cost and Works Accountants Act, 1959).

(ii) The Council of the Institute of Cost Accountants of India had approved posting of particular on website by Cost Accountants in practice under clause (6) of Part-I of First Schedule to the Cost and Works Accountants Act, 1959 subject to the prescribed guidelines. The relevant guidelines are:

- No restriction on the colours used in the website.
- Names of clients and fees charged not to be given.

Clause (7) of Part-I of First Schedule to the Cost and Works Accountants Act, 1959 prohibits a member not to advertise his professional attainments or services other than Cost Accountant professional documents, visiting cards, letter heads or sign boards.

In view of the above, M/s A.P. Shah & Associates would have no restriction on the colours used in the website but failed to satisfy other guidelines.

Thus M/s A.P. Shah & Associates would be held guilty of professional misconduct under clause (6) and clause (7) of Part-I of First Schedule to the Cost and Works Accountants Act, 1959.

(iii) Clause 10 of Part-I of the First Schedule to the Cost and Works Accountants Act, 1959 aims to restrain a member in practice from engaging himself in any business or occupation other than that of a Cost Accountant except when permitted by the Council to be so engaged. Accordingly, in the absence of specific and prior approval, Cost Accountant would be held guilty of professional misconduct. Thus in the instant case CMA Nikhil would be held to be guilty of professional misconduct.

b) **Functions of Audit Committee:** Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include,—

- (i) the recommendation for appointment, remuneration and terms of appointment of auditors of the company;
- (ii) review and monitor the auditor's independence and performance, and effectiveness of audit process;
- (iii) examination of the financial statement and the auditors' report thereon;

- (iv) approval or any subsequent modification of transactions of the company with related parties;
- (v) scrutiny of inter-corporate loans and investments;
- (vi) valuation of undertakings or assets of the company, wherever it is necessary;
- (vii) evaluation of internal financial controls and risk management systems;
- (viii) monitoring the end use of funds raised through public offers and related matters.

c) Corporate Image:

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

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

Corporate Branding:

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

The purpose of corporate branding is to:

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

Evaluation of Corporate Image

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

The following are the steps to evaluate Corporate Image.

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

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- o Summarise the rating under the selected groups and present a composite evaluation to the management.

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

7.

- a) **Differentiate between Management Audit and Operational Audit.** [4]
- b) **'Much good work gets lost because the auditor's report fails to evoke the interest of the Reader'. Discuss the above statement in the context of the report of the operational auditor.** [7]
- c) **Explain the scope of concurrent audit of a bank with reference to Reserve Bank of India guidelines.** [7]

Answer:

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

The basic difference between the two audits is not in method, but in the level of appraisal. In Management Audit, the auditor is to take his tests to the level of top management, its formulations of objectives, plan and policies and its decision making. It is not that he just verifies the operation of control and procedure and fulfillment of plans in conformity with the prescribed policies. In Operational Audit, the Auditor concentrates on the aspects of the operations in which waste, inefficiency and excessive costs would be subject to reduction by the introduction of improvement of operating controls.

- b) The written report is the medium by which the comments, criticisms and recommendations of an audit work are conveyed to Board and to management in general. It follows, therefore, that audit reports crystallize the work of the operational auditor and merit the closest consideration of all audit staff engaged in their preparation. Reports must be written with great care after full consideration of the subject matter and with full regard to the fact that it is imperative that the report conveys exactly the right impression on the reader. As the report is the end result of the whole process of auditing, and being the important communication medium, emphasis should be on making it as effective as feasible.

Accordingly, the report of the operational auditor should be backed by logic and facts and figures about operations reviewed by him to management. This is quite pertinent because the objective of conducting the operational audit would be best achieved only if findings in the report are given attention and implemented to achieve the desired results. Though the fact remains that unless the report contains matters of any worth, mere use of ornamental language is of no value. But the substantial work done by the auditor may totally go waste if the report is not able to hold interest of a reader because it has been drafted in a haphazard manner.

Preparation of an audit report is an art. It should be of such quality that it would keep the interest of the reader alive throughout. Then only the objectives of the report would be

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met. If the matters reported are just glanced through and brushed off, the whole exercise of the operational audit will be a futile exercise.

The objective of the management to get an operational audit carried out is to be appraised of the irregularities and deficiencies in the operations and the general state of affairs. The report must be able to meet this requirement. While drawing up a report, consideration must also be given to the level of management at which the report is sent.

Operational audit is a highly analytical task and therefore, there should be support for what is stated in the report. Relevant facts and figures should be provided to enable the reader to assess the reasonableness of the auditor's opinion and to get a ready idea of the implications of the observations of the audit report.

The operational auditor should exercise care that matters stated are factually correct and are in clear language. He should have a clear perception of the matters of interest to the management.

In addition to the points already stated, the following points should be considered in drafting a report.

- i) The report should be brief, clear and to the point.
- ii) The points should be stated in clear cut paragraphs.
- iii) Facts should be stated in physical as well as monetary terms wherever possible.
- iv) The areas needing improvement should be highlighted as also areas which have shown excellent performance. Stress should be given on items that will improve the operations of the business.
- v) As far as practicable, terms and expressions used should be such that they are familiar to the operating people.
- vi) The draft report should be discussed with the departmental chiefs in order to have check on accuracy.

The report constitutes a record of matters that were brought to the notice of management, and is a basis for the auditor to follow up matters in a subsequent assignment. The report also serves as a basis for decision making by the top management where a decision is called for.

As regards the questions of report vis-à-vis different levels of management, the matter should be decided having regard to the circumstances. If management responsible for getting the operational audit being carried out wants only report to be made to it, there does not arise any question of making report to other. In a flexible situation, however the operational auditor may make different reports for different levels of management. Reports made to departmental chiefs should usually contain matters relating to routine procedures. A report to high management should invariably be restricted matters of policies, objectives, control, serious irregularities, lost opportunities or further possibilities. Thus, the objectives of the operational audit would be totally lost in case the report fails to evoke interest of the management.

c) Scope of concurrent audit of banks with reference to RBI guidelines :

- 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.

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- 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.

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

[6×3=18]

- a) Cut-off procedures**
- b) key functions of an Energy Auditor**
- c) Customer Costing in Service Sector**
- d) QRB**

Answer:

- a)** 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.

b) Key functions of Energy Auditor :

Energy auditing is defined as an activity that serves the purposes of assessing energy use pattern of a factory or energy consuming equipment and identifying energy saving opportunities. In that context, energy management involves the basis approaches reducing avoidable losses, improving the effectiveness of energy use, and increasing

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energy use efficiency. The function of an energy auditor could be compared with that of a financial auditor. The energy auditor is normally expected to give recommendations on efficiency improvements leading to monetary benefits and also advise on energy management issues.

Generally, energy auditor for the industry is an external party. The following are some of the key functions of the energy auditor:

- i) Quantification of energy costs and quantities.
- ii) To correlate trends of production or activity to energy cost.
- iii) To devise energy database formats to depict to correct picture – By product, department or consumer.

While performing the aforesaid key functions, the energy auditor is required to carry out the following activities:

- i) To analyze the historical energy consumption and cost data.
- ii) To conduct preliminary energy audit with the objectives to identify:
 - a. major energy consuming equipment and process;
 - b. obvious inefficiencies and energy wastes; and
 - c. Priority areas for further detailed investigation.
- iii) To conduct detailed technical and economic analysis of energy efficiency measures involving large efficiency measures involving large capital investment or long payback periods.

- c)** Customer Costing is a new approach to management and the central theme of this approach is customer satisfaction. In some service industries, such as public relations, the specific output of the industry may be difficult to identify and even more difficult to quantify. The variety of activities of a Bank for a customer can be cited in this regard. These are:

- i) Stopping cheque
- ii) Withdrawal of cash
- iii) Updating of pass book
- iv) Issue of duplicate pass book
- v) Cheque returns
- vi) Clearing of cheques.

For customer costing purpose, the cost is divided into following categories. These are:

- i) Customer specific costs — like the cost of express conveyer to a client/customer who requests oversight delivery of some important document.
- ii) Customer line categories — these are the costs which are broken into the broad categories of customers and not individual customer.
- iii) Company costs — those costs which are not allocated to either customer line or individual customers but charge to company. The example is the cost of advertisement to promote sale of service.

- d) QRB:** Stands for Quality Review Board. The Government of India, Ministry of Corporate Affairs has set up a Quality Review Board to evaluate various services being provided by the members of the Institute vide Gazette Notification Number S.O. 1693 (E) dated 3rd October 2007. Section 29A of the Cost and Works Accountants of India provides for establishment of Quality Review Board. Section 29B of the Act relates to the functions of the Board. It provides that the Board shall perform the following functions :

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- i) Make recommendations to the Council with regard to the quality of services provided by members of the Institute.
- ii) Guide the members of the Institute to improve the quality of services, provided by the members of the Institute including cost advisor services.
- iii) Review the quality of services and adherence to the various statutory and other regulatory requirements.

The constitution of QRB is therefore aimed at maintenance as well as enhancement of quality of attestation services or cost audit services and to provide guidance to members to improve performance. The quality review process is mainly focused on :

- Compliance with technical standards
- Quality of reporting
- Office System and procedures
- Training programmes for staff concerned including appropriate infrastructure.