COST & MANAGEMENT AUDIT

Group - III
Paper - XIX

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA
(Statutory body under an Act of Parliament)
www.icmai.in

SYLLABUS - 2016

WORK BOOK

COST AND MANAGEMENT AUDIT

FINAL

GROUP – IV

PAPER – 19

The Institute of Cost Accountants of India

(Statutory body under an Act of Parliament)

www.icmai.in

First Edition : May 2018

Second Edition : April 2019

Published By :

Directorate of Studies

The Institute of Cost Accountants of India

CMA Bhawan, 12, Sudder Street, Kolkata – 700 016

www.icmai.in

Preface

Professional education systems around the world are experiencing great change brought about by the global demand. Towards this end, we feel, it is our duty to make our students fully aware about their curriculum and to make them more efficient.

Although it might be easy to think of the habits as a set of behaviours that we want students to have so that we can get on with the curriculum that we need to cover. It becomes apparent that we need to provide specific opportunities for students to practice the habits. Habits are formed only through continuous practice. And to practice the habits, our curriculum, instruction, and assessments must provide generative, rich, and provocative opportunities for using them.

The main purpose of this volume is to disseminate knowledge and motivate our students to perform better, as we are overwhelmed by their response after publication of the first edition. Thus, we are delighted to inform our students about the **e-distribution of the second edition of our 'Work book'.**

This book has been written to meet the needs of students as it offers the practising format that will appeal to the students to read smoothly. Each chapter includes unique features to aid in developing a deeper under-standing of the chapter contents for the readers. The unique features provide a consistent reading path throughout the book, making readers more efficient to reach their goal.

Discussing each chapter with illustrations integrate the key components of the subjects. In the second edition, we expanded the coverage in some areas and condensed others.

It is our hope and expectation that this second edition of work book will provide further an effective learning experience to the students like the first edition.

The Directorate of Studies,

The Institute of Cost Accountants of India

COST AND MANAGEMENT AUDIT

FINAL

GROUP – IV

PAPER – 19

INDEX

SUGGESTED MARKS DISTRIBUTION FROM EXAMINATION POINT OF VIEW

Only for Practice Purpose

Total 100 Marks	3 Hours	MCQ = 20 Marks
		Others = 80 Marks

Objective Question

20 Marks (2 Marks each questions)	MCQ	1 mark for correct answer
		1 mark for justification

Short Notes / Case Study

Minimum Marks for each Questions	3 Marks
Maximum Marks for each Questions	10 Marks

Practical Problem

Minimum Marks for each Questions	4 Marks
Maximum Marks for each Questions	16 Marks

Study Note – 1

BASIS OF COST AND MANAGEMENT AUDIT

Learning Objective: *This chapter helps to know about basis of Cost Audit. Cost Audit represents the verification of cost accounts and check on the adherence to cost accounting plan and also ascertain the accuracy of cost accounting records to ensure that they are in conformity with Cost Accounting principles, plans, procedures and objective.*

1. Choose the correct option among four alternative answer and justify your answer:

(I) The Company has to upload the cost audit report electronically to the MCA through Form _____________.

a) CRA – 4
b) CRA – 3
c) CRA – 2
d) CRA – 1

(II) Cost Audit was initially introduced in the year _____________

a) 1959.
b) 1965.
c) 1949.
d) 1975.

(III) Cost Records are maintained on ______________ basis.

a) Accrual
b) Cash
c) Actual
d) None of these

(IV) Item appearing only in Cost Records is _____________.

a) Profit on Sale of Assets
b) Interest Received
c) Loss on Sale of Assets
d) Notional Interest on Capital

(V) **The cost records are to be maintained as specified in:**
- a) CRA3
- b) CRA1
- c) CRA 4
- d) CRA 2

(VI) **Cost Information ____________ the organization to structure the cost, understand it and use it for communicating with the stakeholders.**
- a) Enables
- b) Disables
- c) Useful
- d) None of these

(VII) **Costing includes product, process, and resource-related information covering the ____________ of the organization and its value chain.**
- a) Performance
- b) Ability
- c) Consistency
- d) Functions

(VIII) **Costing is an important tool in ____________ organizational performance in terms of shareholder and stakeholder value.**
- a) Determining
- b) Calculating
- c) Assessing
- d) None of these

(IX) **The Cost Auditor appointed has to render the cost audit report to the board of directors of the Company, as per the specified time limit, in Form ___________.**
- a) CRA-3
- b) CRA – 1
- c) XBRL
- d) CRA – 2

(X) **Cost Audit represents true and faire view of the ___________ of any product.**
- a) Cost of sale
- b) Cost of raw material consumption
- c) Cost of production
- d) None of these

(XI) Cost Audit ____________ conducted by a Chartered Accountant.

a) May be
b) Can be
c) Cannot be
d) May not be

(XII) 'Sugar and Industrial Alcohol' belong to ________________ sector for the purpose of Application of Cost Records.

a) Regulated
b) Non-Regulated
c) Both depending on circumstances
d) None of above.

Answer:

1.

(I) CRA - 4

(II) 1965

(III) Accrual

(IV) Notional interest on capital. - This does not involve actual outlay of funds but is included in cost records as an opportunity cost to determine product cost. The other three items are not related to actual production and this do not form part of cost records.

(V) CRA1.-- Pursuant to Rule 5(1) of the Companies(Cost Records and Audit) Rules, 2014

(VI) Enables

(VII) Functions

(VIII) Assessing

(IX) CRA – 3

(X) Cost of Production

(XI) Can Not Be

(XII) Regulated - As per Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 Table A.

2. a) How cost information helps the organization and Management?

b) What are the objectives of Cost Audit?

Answer:

2. (a)

1) Cost information enables the organization to structure the cost, understand it and use it for communicating with stakeholders
2) 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.
3) 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.
4) 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.
5) 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.
6) Integrating databases and information systems can help to provide useful costing information more efficiently as well as reducing source data manipulation.

(b) Cost Audit has both general and social objectives. The general objectives can be described to include the following:

General Objectives:

- Verification of cost accounts with a view to ascertaining that these have been properly maintained and compiled according to the cost accounting system followed by the enterprise.
- Ensuring that prescribed procedures of the cost accounting records rules are duly adhered to.
- Detection of errors and fraud.

- Verification of the cost of each "cost unit" and "cost center" to ensure that these have been properly ascertained.
- Determination of inventory valuation.
- Facilitating the fixation of prices of goods and services.
- Periodical reconciliation between cost accounts and financial accounts.
- Ensuring optimum utilization of human, physical and financial resources of the enterprise.
- Detection and correction of abnormal loss of material and time
- Inculcation of cost consciousness.
- Advising management, on the basis of inter-firm comparison of cost records, as regards the areas where performance calls for improvement.
- Promoting corporate governance through various operational disclosures to the directors.

Socials Objectives:

- To see whether the pricing of the products are justified as per the product and quality are concerned,
- To remove the disparities, if any, in the pricing of products and/or services.
- To look into that no cost based economic imbalance may occur in product and /or services.
- To facilitate in the global market cost competitiveness of the products.

3. a) Which Companies are required to maintain Cost Records?

b) What are 'Books of Accounts' as per the Companies Act, 2013? Do 'Cost Records' become part of Books of Accounts?

Answer:

3. (a) The Companies Act, 2013 empowers the Central Government to make the rules in the area of maintenance of cost records by the companies engaged in the specified industries, manufacturing/providing such goods services; and forgetting such cost records audited, vide Section 148.

Thus, it is the "subordinate legislative power" of the Central Government, to make rules for maintenance of cost records and audit thereof in respect of specific industries. Accordingly, the Central Government made, from time to time, several notifications / orders, ever since the provisions were made in the erstwhile Companies Act, 1956, as well as under the current Act of 2013.

Any domestic or foreign company, falling under regulated or non-regulated sectors and engaged in production of goods or provision of services with overall turnover from all its products or services is equal or more than ₹35 crores in preceding financial year is required to maintain Cost Records.

(b) Section 2(13) of Companies Act, 2013 states that: "Books of Accounts" includes records maintained in respect of-

1) All sums of money received and expended by a company and matters in relation to which receipts and expenditure take place;
2) All sales and purchases of goods and services by the company
3) The assets and liabilities of the company and
4) The items of cost as may be prescribed under section 148 in the case of company which belongs to any class of companies specified under that section.

Section 148 of Companies Act 2013 empowers the "central government to specify audit of items of costs in respect of certain companies".

As per Rule 2 (e) of the Companies (Cost Records and Audit) Rules 2014, "cost records" means books of accounts relating to utilization of materials, labour and other items of cost as applicable to the production of goods or provision of services as provided in Section 148 of the Act and such rules.

Study Note – 2

COMPANIES (COST RECORDS AND AUDIT) RULES, 2014

Learning Objective: *The Central Government issued Companies (Cost Records and Audit) Rules, 2014 on June 30, 2014. Subsequently, it issued Companies (Cost Records and Audit) Amendment Rules, where certain changes to the original Rules issued on June 30, 2014. The Companies (Cost Records and Audit) Rules, 2014 read with the Amendment Rules 2014 are now applicable and governs the maintenance of cost accounting records and cost audit as per Section 148 of the Companies Act, 2013; This chapter discusses all those mentioned.*

1. Choose the correct option among four alternative answer and justify your answer:

(I) The form in which the cost records shall be maintained __________.

a) CRA-1
b) CRA-2
c) CRA-3
d) CRA-4

(II) The Cost Audit Report under CCRA – Rules, 2014 is to be submitted in ___________.

a) CRA-1
b) CRA-2
c) CRA-3
d) CRA-4

(III) The form in which appointment of cost auditor by the company to Central Government is intimated _____________.

a) CRA-1
b) CRA-2
c) CRA-3
d) CRA-4

(IV) The applicability of maintenance cost records under CCRA – Rules, 2014 for regulated industries having overall turnover of

a) ₹ 25.00 crores
b) ₹ 35 .00 crores
c) ₹ 50.00 crores
d) ₹ 100.00 crores

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

a) Fertilizers

b) Paper

c) Sugar

d) Petroleum products

(VI) The cost auditor shall be appointed within ___________ days of the beginning of the financial year.

a) 60 days

b) 90 days

c) 180 days

d) 270 days

(VII) Any casual vacancy in the office of a cost auditor, whether due to resignation, death or removal to be filled by the Board of Directors within ___________days of occurrence of such vacancy.

a) 30 days

b) 60 days

c) 90 days

d) 180 days

(VIII) Every cost auditor shall forward his duly signed report to the Board of Directors of the company within a period of ___________ days from the closure of the financial year to which the report relates.

a) 60 days

b) 90 days

c) 180 days

d) 270 days

Answer:

1.

(I) (a) CRA-1

The form CRA-1 prescribes the form in which cost records shall be maintained. The form categorizes the requirement of maintaining proper details as per 30 headings. The headings are 1. Material Cost, 2. Employee Cost, 3. Utilities etc.

(II) (c) CRA-3

Every cost auditor, who conducts an audit of the cost records of a company, shall submit the cost audit report along with his or its reservations or qualifications or observations or suggestions, if any, in form CRA-3.

(III) (b) CRA-2

Every company referred to in sub-rule (1) shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of thirty days of the Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in form CRA-2, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

(IV) (b) ₹ 35.00 crore

The applicability of maintenance cost records under CCRA – Rules, 2014 for regulated industries having overall turnover of ₹ 35.00 crores or more.

(V) (b) Paper

Paper industry is a non-regulated industry.

(VI) (c) 180 days

As per Rule-6 of the Companies (Cost Records and Audit) Rules, 2014 the cost auditor shall be appointed within 180 days of the beginning of the financial year.

(VII) (a) 30 days

As per Rule-6 of the Companies (Cost Records and Audit) Rules, 2014, Any casual vacancy in the office of a cost auditor, whether due to resignation, death or removal to be filled by the Board of Directors within thirty days of occurrence of such vacancy and the company shall inform the Central Government in Form CRA-2 within thirty days of such appointment of cost auditor.

(VIII) (c) 180 days

Every cost auditor shall forward his duly 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 and the Board of Directors shall consider and examine such report, particularly any reservation or qualification contained therein.

2. (a) Discuss about the applicability of Cost Audit?

(b) Write any 5 disqualifications relating to appointment of cost auditor.

Answer:

2. (a) Applicability of cost audit:

(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"

(b) The following persons are not eligible for appointment as a cost auditor:

(i) A body corporate

(ii) An officer or employee of the company.

(iii) A person who is a partner, or who is in the employment, of an officer or employee of the company.

(iv) A person who is indebted to the company or its subsidiary, or its holding or associate company or a subsidiary or such holding company, for an amount exceeding ₹ 5 lakhs.

(v) A person or a firm who, whether directly or indirectly, has business relationship with the company, its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company.

3. (a) Is a cost auditor required to audit and certify monthly, quarterly, half-yearly and yearly cost statements?

(b) What is the meaning of "Turnover" in relation to the Companies (Cost Records and Audit) Rules, 2014?

Answer:

3. (a) As per Rule 5, every company under these rules including all units and branches thereof are required, in respect of each of its financial year, to maintain cost records in form CRA-1. The cost records are required to be maintained on regular basis in such manner so as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis. The cost auditor is appointed to conduct audit of the cost records and make report thereon for the financial year for which he is appointed. It is not incumbent upon the cost auditor to certify monthly, quarterly, half-yearly cost statements.

(b) Sub-section 91 of Section 2 of the Companies Act, 2013 defines "turnover" as "the aggregate value of the realization of amount made from the sale, supply or distribution of goods or on account of services rendered, or both, by the company during a financial year. For the purposes of these Rules, "Turnover" means gross turnover made by the company from the sale or supply of all products or services during the financial year. It includes any turnover from job work or loan license operations but exclude duties and taxes. Export benefit received should be treated as a part of sales.

4. (a) Whether separate Form CRA-2 is required to be filed by a company having two or more different types of products covered under cost audit?

(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	Value in ₹
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.

Answer:

4. (a) CRA-2 Form (intimation for appointment of cost auditor to Central Government) has replaced the earlier Form 23C (application seeking approval for appointment of cost auditor). A single Form CRA-2 is required to be filed providing details of the sectors/industries covered under cost audit and details of cost auditor. For Companies appointing multiple cost auditors, only one single Form CRA-2 is required to be filed. Provision has been made in the Form to accommodate details of multiple cost auditors.

(b)

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

Particulars	₹	₹
Profit as per Financial Accounts		**22,14,100**
Add: Loss on sale of investments	33,600	
Add: Voluntary Retirement compensation included in salary	50,25,000	
and wages in F/A - Not included in cost A/c	75,000	51,33,600
Add: Donation paid		73,47,700
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	53,37,200
Profit as per Cost Accounts		**20,10,500**

Study Note – 3

COST AUDIT DOCUMENTATION AND AUDIT PROCESS

Learning Objective: ***This chapter discusses about how in documenting the nature and extent of audit procedures performed, the Cost Auditor shall record the characteristics of the specific items or matters tested the responsibility for performing and reviewing such procedures and the relevant dates. The Cost Auditor shall prepare audit documentation that is sufficient to enable another Cost Auditor undertaking a peer review to understanding.***

1. Choose the correct option among four alternative answer and justify your answer:

(I) Cost Auditing Standard _____________ deals with Cost Audit Documentation.

a) 101
b) 102
c) 103
d) 104

(II) What is the first stage of an audit of cost statement?

a) Planning
b) Performing
c) Reporting
d) None of the above.

(III) What is the final stage of an audit of cost statement?

e) Planning
f) Performing
g) Reporting
h) None of the above.

Answer:

1. (I) (b) 102

Cost Auditing Standard – 102 deals with Cost Audit Documentation. The purpose of this Standard is to provide guidance to the members in preparation of Audit Documentation in the context of the audit of cost statements, records and other related documents.

(II) (a) Planning
Planning is the first stage of an audit. The planning stage involves determining the audit strategy as well as identifying the nature and the timing of the procedures to be performed.

(III) (c) Reporting
Reporting is the final stage of an audit. The auditor's opinion is expressed in the audit report. The final stage of the audit involves drawing conclusions based on the evidence gathered and arriving at an opinion regarding the fair presentation of cost statements.

2. (a) What is meant by Cost Audit Documentation?

(b) Discuss about the requirements of Cost Audit Documentation.

Answer:

2. (a) Audit helps to detect errors and frauds and provides suggestions to improve them which intern, help the management to take corrective action. To complete the audit process one need to gather the documents related to audit process. Cost Audit Documentation means the material including working papers prepared by and for, or obtained and retained by the cost auditor in connection with the performance of the audit.

Cost Auditing Standard – 102 deals with Cost Audit Documentation. The objective of this Standard is to guide the members to prepare documentation that provides:

(i) A sufficient and appropriate record of the basis for the Cost Auditor's Report; and
(ii) Evidence that the audit was planned and performed in accordance with Cost Auditing Standards and applicable legal & regulatory requirements.

(b) The requirements of Cost Audit Documentation are:

(i) The cost auditor as part of the audit documentation shall record audit procedures performed, relevant audit evidence obtained, and conclusions reached.
(ii) The Cost Auditor shall prepare audit documentation that is sufficient to enable another competent person, having no previous connection with the said audit, including person undertaking peer review to understand:
   (a) Conformance of audit procedures performed with legal and regulatory requirements;
   (b) Conformance to Cost Auditing Standards.
   (c) The results of audit procedures performed

(d) The audit evidence obtained

(e) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

(iii) The Cost Auditor shall record the discussions of significant matters with client personnel and outsiders.

(iv) The Cost Auditor shall record any departure from the standard requirement in a Cost Auditing Standard.

(v) In documenting the nature, timing and extent of audit procedures performed, the Cost Auditor shall record the characteristics of the specific items or matters tested, the persons responsible for performing and reviewing such procedures with relevant dates and extent of review.

(vi) The Cost Auditor shall prepare audit documentation on a timely basis.

(vii) If, in exceptional circumstances, Cost Auditor performs any new or additional audit procedures or draws new conclusions, after the date of Cost Audit Report, then he shall document such circumstances and details of such procedures performed.

(viii) The cost auditor shall assemble the audit documentation in an audit file.

3. (a) Discuss about the contents of Cost Audit Documentation.

(b) Indicate the matters to be included in the Cost Audit Documentation with respect to smaller entities.

Answer:

3. (a) The Cost Audit documentation will usually contain:

(i) Checklists 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.

(b) The following matters should be included in the Cost Audit Documentation in respect of smaller entities:

(i) A description of the entity, the products produced, services provided and other activities

(ii) An organization Chart showing the responsibility centres and the person responsible

(iii) A description, preferably a flow chart of the manufacturing process

(iv) Internal controls over material cost, labour cost and expenses

(v) The risks of material misstatement assessed, for example, in respect of scrap recovery and disposal

(vi) Tests of materiality used

(vii) The overall audit strategy and audit plan

(viii) Significant matters noted during the audit, and conclusions reached

4. (a) What do you mean by Audit File?

(b) Discuss about the content of Current Audit File.

Answer:

4. (a) Audit file means one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation which are linked directly or indirectly with the audit process.

The cost auditor shall assemble the audit documentation in an audit file. The final audit file should be completed within a reasonable time after the completion of the audit. After the assembly of the final audit file has completed, the auditor should not delete or discard audit documentation of any nature before the end of its retention period.

(b) In case of recurring audits, some working papers files may be classified into permanent audit files and current audit files. While the former is updated with the information of continuing importance, the latter contains information relating to audit of a single period.

The contents of Current Audit File are given below:

(i) Correspondence relating to acceptance of annual reappointment.

(ii) Extracts of important matters in the minutes of Board Meetings and General Meetings relevant to the audit.

(iii) Copies of management letters.

(iv) Analysis of transactions and balances.

(v) Copies of communication with other auditors, experts and third parties.

(vi) Audit programme.

(vii) Conclusions reached on significant aspects of audit.

5. (a) Write a short note on Audit working papers?

(b) Discuss about the stages of an Audit of cost statement.

Answer:

5. (a) Audit working papers are the documents which record all audit evidence obtained during audit. Such documents are used to support the audit work done in order to provide assurance that the audit was performed in accordance with the relevant Cost Audit and Assurance Standards.

Auditors retain a set of working papers for each audit engagement for each year. The audit working papers for the current year are referred to as the current working papers. Working papers that are relevant to more than one audit engagement are often kept separately in a file referred to as permanent working papers. The audit working papers (current and permanent) for a client audit engagement are sufficiently detailed to enable another appropriately experienced and competent auditor that is not familiar with the client to obtain an overall understanding of the engagement.

Working papers (or documentation) serve three purposes:

(i) aid in planning and performance of the audit;

(ii) aid in supervision and review of the audit work; and

(iii) these papers serve as an evidence of the audit work performed by the auditor to support his opinion.

(b) The stages of an audit of cost statements are

1) Planning
2) Performing and
3) Reporting

1. **Planning Stage:**
   Once the entity's acceptance or continuation decision has been made, the first stage is planning the audit. The planning stage involves:
   (i) Understanding the entity and its environment
   (ii) Risk identification and Strategy
   (iii) Risk and materiality assessment

   A well-planned audit will ensure that sufficient appropriate evidence is gathered to minimize risk of material misstatement at the cost statement level.

2. **Performing Stage:**
   The second stage is performance or execution stage of the audit, which involves detailed testing of internal controls, material consumptions, cost accumulation, allocation, apportionment, and absorption. This detailed testing provides the evidence that the cost auditor requires to determine whether the cost statements have been fairly presented. The performing stage involves:
   (i) Execution
   (ii) Audit Procedures
   (iii) Audit Findings

3. **Reporting Stage:**
   The final stage of the audit involves drawing conclusions based on the evidence gathered and arriving at an opinion regarding the fair presentation of cost statements. The cost auditor's opinion is expressed in the cost audit report. At this stage of the audit, a cost auditor will draw on their understanding of the client, their detailed knowledge of the risks faced by the client, and the conclusions drawn when testing the entity's controls, transactions, cost heads, item of cost and related disclosures. So, the final or reporting stage involves:
   (i) Conclusion
   (ii) Reporting.

6. (a) Which documents are to be maintained for Audit Documentation?

(b) In case of practical audit process, mention the steps to be followed by a cost auditor?

Answer:

6. (a) Audit Documentation is a vital part of audit process. The following documents are to be maintained for audit documentation:

i) Document audit plan, audit strategy

ii) Document all working papers
iii) Document all the audit evidences
iv) Document draft observations and discussions
v) Document final report
vi) Preserve all documents in a bound folder/file for the prescribed period

(b) In order to conduct practical audit, the following steps are to be followed by a cost auditor:

Step I: Objectives of Audit and Management Outlook i.e. cost optimization or cost reduction, checking parameters of operational efficiency of a unit or any utility or any other function or department, identifying profit making or loss making products, suggesting changed marketing strategies, complete review of business strategies etc.

Step II: Pre-conditions i.e. Objectives of cost audit, Area, nature and scope of audit, Number of cost auditors appointed, the applicable reporting framework, the reporting period, the statutory deadlines etc.

Step III: Understanding the Company's Business i.e. the cost auditor is required to understand the company's business, its corporate structure and various systems followed like Internal Control Systems, Internal Audit System, Accounting Systems & Policies , Cost Accounting System & Policies, Company's MIS system, risk identification & management system, IT policy, IT data security policy etc.

Step IV: Planning the Audit which includes timing and duration of audit period, Level and number of audit personnel to be deployed, audit partner to be deployed, drawing up an overall audit plan and audit strategy, Formulating appropriate audit procedures etc.

Step V: Execution of Audit i.e. Perform the audit checks and procedures as planned, Collect all required audit evidence and validate their relevance, reliability and accuracy, Prepare draft observations & discuss with key management personnel and Prepare final audit report.

Step VI: Audit Documentation i.e. Document audit plan, audit strategy, working papers, draft observations, final report etc. and preserve all documents in a bound folder/file for the prescribed period

Study Note – 4

COST AUDITOR – PROFESSIONAL ETHICS AND RESPONSIBILITIES

Learning Objective: ***This chapter helps to know about the Professional Behaviour of the cost auditor while meeting his responsibilities to clients, third parties, other members of the cost and management accounting profession, staff, employers and the general public.***

1. Choose the correct option among four alternative answer and justify your answer:

(I) "Cost auditor" means a Cost Accountant in practice, as defined in clause (b), who is appointed, by the Board. This definition is given under _______________.

a) Rule 2(a)

b) Rule 2(b)

c) Rule 2(c)

d) None of the above

(II) A person shall be punishable for first time conviction for falsely claiming to be a member with fine which may extend to rupees ______________.

a) ₹ 1,000

b) ₹ 2,000

c) ₹ 3,000

d) ₹ 5,000

(III) There are _______________ to the Act clarifies or indicates that the schedules provide an illustrative list of acts and omissions constituting "professional or other misconduct

a) two schedules

b) three schedules

c) four schedules

d) five schedules

Answer:

1. (I) (c) Rule 2(c)

(II) (a) ₹ 1,000

Being a member of the Institute, but not having a certificate of practice, represents that he is in practice or practices as a cost accountant, shall be punishable on first conviction with fine which may extend to one thousand rupees.

(III) (a) two schedules

As per section 22 of the Cost and Works Accountants Act, 1959 there are two schedules to the Act clarifies or indicates that the schedules provide an illustrative list of acts and omissions constituting "professional or other misconduct".

2. (a) Write a short note on Code of Ethics in the field of Cost and Management Accounting.

(b) Discuss about the fundamental principles to be observed by the cost accountants.

Answer:

2. (a) As professionals in the field of Cost and Management Accounting, the members of the Institute are bound by a code of professional ethics. This code stipulates and binds them to the highest level of care, duty and responsibility to their employers and clients, the public and their fellow professionals.

The objectives of the accountancy profession are to work to the highest standards of professionalism, to attain the highest levels of performance and generally to meet the public interest requirement. These objectives require four basic needs to be met:

(i) Credibility in information and information systems;
(ii) Professionalism identified by employers, clients and other interested parties;
(iii) Quality of service carried out to the highest standards of performance; and
(iv) Confidence that there is a framework of professional ethics to govern the provision of services.

(b) The following fundamental principles should be observed by the cost accountants, to achieve the objectives of the accounting profession:

(a) **Integrity:** A cost accountant should be straightforward and honest in performing his services.

(b) **Objectivity**: A cost accountant should be fair and should not allow prejudice or bias or the influence of others to override objectivity.

(c) **Competence**: A cost accountant must refrain from performing any service which he is not competent to carry out unless proper advice and assistance is obtained to ensure that the service is performed to the satisfaction.

(d) **Confidentiality**: A cost accountant must not disclose information acquired during the course of his engagement and should not use or disclose any such information without proper and specific authority or unless there is a legal or professional right or duty to disclose.

(e) **Professional behavior:** A cost accountant should act in a manner consistent with the good reputation of the profession.

In addition to the fundamental principles above a cost accountant in practice, should be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity, objectivity and independence.

3. (a) As per Section 143 of the Companies Act, 2013 what is the duty of a Cost Auditor to Report Fraud

(b) Discuss about the punishment of fraud (Section 447 of the Companies Act, 2013).

Answer:

3. (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.

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 he 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.

(b) Without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud:

Provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

4. (a) Write a short note on Professional misconduct in relation to members of the Institute in service.

(b) Mention at least 5 Professional misconduct in relation to members in practice in terms of second schedule.

Answer:

4. (a) Professional misconduct in relation to members of the Institute in service

A member of the Institute in service (other than a member in practice) shall be deemed to be guilty of professional misconduct, if he being an employee of any company, firm or person –

1. Pays or allows or agrees to pay, directly or indirectly, to any person any share in the emoluments of the employment undertaken by him;
2. Accepts or agrees to accept any part of fees, profit or gains from a lawyer, a cost accountant or broker engaged by such company, firm or person or agent or customer of such company, firm or person by way of commission or gratification.

(b) A cost accountant in practice shall be deemed to be guilty of professional misconduct, if he:—

(i) discloses information acquired in the course of his professional engagement to any person other than his client so engaging him, without the consent of his client, or otherwise than as required by any law for the time being in force;

(ii) certifies or submits in his name, or in the name of his firm, a report of an examination of cost accounting and related statements unless the examination of such statements has been made by him or by a partner or an employee in his firm or by another cost accountant in practice;

(iii) expresses his opinion on cost or pricing statements of any business or enterprise in which he, his firm or a partner in his firm has a substantial interest;

(iv) fails to report a material misstatement known to him to appear in a cost or pricing statement with which he is concerned in a professional capacity;

(v) does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.

Study Note – 5

OVERVIEW OF COST ACCOUNTING STANDARDS AND GACAP

Learning Objective: *This chapter helps to know about the conceptual frame work of cost accounting standards. Generally Accepted Cost Accounting Principles (GACAP) contains a summary of the Cost accounting principles currently followed by business entities in India in preparing and presenting cost information in the context of general purpose cost statements for statutory reporting and covered by Cost Audit.*

1. Choose the correct option among four alternative answer and justify your answer:

(I) As per CAS 2 Actual Capacity utilization shall be presented as a percentage of ________________ capacity.

a) Installed Capacity
b) Practical Capacity
c) Abnormal Loss (%)
d) Actual Production

(II) CAS-20 deals with __________

a) Royalty and Technical Knowhow fee.
b) Material Cost.
c) Research & Development Cost.
d) Financial Cost.

(III) CAS 5 deals with_________

a) Equalized cost of transportation
b) Captive consumption
c) Capacity determination
d) Cost classification.

(IV) CAS-14 deals with __________

a) Cost of Inventory
b) Utilities Cost
c) Pollution Control Cost
d) None of above

(V) The Cost Accounting Standard 15 is a Cost Accounting Standard on _______.
a) Employees Cost
b) Utilities Cost
c) Pollution Control Cost
d) Selling & Distribution Cost

(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) Administrative Overhead

(VII) Variances due to abnormal reasons ------------ form part of cost as per GACAP.
a) Will Not
b) Is
c) Are
d) Will

(VIII) CAS 11 deals with:
a) Administrative Overhead
b) Factory Overhead
c) Selling & Distribution Overhead
d) Financial Cost

(IX) The foreign exchange component of imported material is converted at the rate on –
a) Date of Payment
b) Date of Delivery
c) Date of Transaction
d) Date of Use

(X) Cost Accounting Standard 8 is a Cost Accounting Standard on ___________
a) Employees Cost
b) Utilities Cost
c) Pollution Control Cost
d) Selling & Distribution Cost

Answer:

1. (I) Installed Capacity

(II) Royalty and Technical Knowhow fee.

(III) Equalized cost of transportation. -- The objective of the standard is to bring uniformity in the application of principles and methods used in the determination of averaged/ equalized transportation cost.

(IV) Pollution Control Cost.

(V) Selling and Distribution Overhead Cost.--CAS 15 deals with the principles and methods of classification, measurement and assignment of Selling and Distribution Overheads, for determination of the cost of sales of product or service, and the presentation and disclosure in cost statements.

(VI) Direct Material cost -- As per the GACAP, Direct Materials Cost includes cost of procurement and freight inwards of the materials.

(VII) Will Not

(VIII) Administrative Overheads. This standard deals with the principles and methods of classification, measurement and assignment of administrative overheads, for determination of the Cost of product or service, and the presentation and disclosure in cost statements.

(IX) Date of transaction. This is as per CAS 6 and GACAP

(X) Utilities Cost --CAS 8 deals with the Cost Accounting Standard on cost of utilities.

2.

a) HowwouldyoucomputecostofutilitiesasperCAS8infollowingcircumstances?

i) Utilities generated for the purpose of inter unit transfers.

ii) Utilities generated for the inter company transfers.

b) As a part of management strategy SEASENA LTD. Manufacturing soaps, purchased a popular soap brand ― SUN FLOWER ‖ from a smaller company. What will be treatment of such costs and the disclosure to be made in the Cost Statements as per relevant Cost Accounting Standard?

Answer:

2. (a) (i) Cost of utilities generated for the purpose of inter unit transfers shall comprise of direct material cost, direct employee cost, direct expenses, factory overheads and the distribution cost incurred for such transfers.

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

(b) The expenses paid or incurred for purchase of a brand is lump-sum in nature and purchased for the increase in revenue income over a long period of time. As per Cost Accounting Standard10, expenses which are in the nature of one-time' payment, shall be amortized on the basis of the estimated output or benefit to be derived from such direct expenses. The expenses for which the benefit is ensued in the future period shall be equated with the estimated production / service volumes for the effective period and based on volume achieved during the Cost Accounting period. Accordingly, the charge for amortization shall be determined. In the given situation, the company is likely to be benefitted from the brand image of the product and the costs so amortized be treated as Selling Expenses over the estimated life of the brand image.

As per CAS-10, the cost statements on direct expenses shall normally disclose the following:

1) The basis of distribution of Direct Expenses to the cost objects /cost units.
2) Quantity and rates of items of Direct Expenses, as applicable.
3) Where Direct Expenses are accounted at standard cost, the price and usage variances.
4) Direct expenses paid /payable to related parties.
5) Direct Expenses incurred in foreign exchange.
6) Anysubsidy/Grant/incentive/credit/recoveriesandanysuchpaymentbereducedfrom Direct Expenses.

Disclosure shall be made only where expenses are material, significant and quantifiable and be made in the body of the Cost Statement or as a footnote or as a separate schedule.

3.

a) How would you treat the following as per the CAS 7 related to Employee Cost?

i) Separation Cost due to voluntary retirement, retrenchment termination, etc.

ii) Idle Time Cost.

b) How do you define 'Packing Material' as per the Generally Accepted Cost Accounting Principle? What is the treatment of such cost?

Answer:

3. (a) (i) Separation costs related to voluntary retirement, retrenchment, termination etc, shall be amortized over the period benefiting from such costs. The amortized separation costs for the period shall be treated as indirect cost and assigned to the cost objects in an appropriate manner. However unamortized amount related to discontinued operations, shall not be treated as Employee Cost but should be charged to Profit and Loss account.

(ii) Idle Time Cost shall be assigned direct to the cost object or treated as overheads depending on the economic feasibility and the specific circumstances causing such idle time. Cost of Idle time for reasons anticipated like normal lunchtime, holidays etc is normally loaded in the employee cost while arriving at the cost per hour of an employee/a group of employees whose time is attributed direct to the cost objects.

(b) The Cost Accounting Standard on Packing Material Cost (CAS 9) defines Packing Materials as materials used to hold, identify, describe, store, protect, display, transport, promote and make the product marketable.

Packing Materials for the purpose of the standard are classified into primary and secondary packing materials. Primary Packing Material is that packing material which is essential to hold and preserve the product for its use by the customer. Secondary Packing Material is that packing material that enables to store, transport, inform the customer, promote and otherwise make the product marketable. For example, in pharmaceutical industry', cartons used for holding strips of tablets and card board boxes used for holding cartons.

Packing material costs shall be directly traced to a cost object to the extent it is economically feasible. Where the packing material costs are not directly traceable to the cost object, these may be assigned on the basis of quantity consumed or similar measures like technical estimates. The packing material cost of reusable packing shall be assigned to the cost object taking into account the number of times or the period over which it is expected to be reused. Cost of primary packing materials shall form part of the cost of production. Cost of secondary packing materials shall form part of distribution overheads.

4.

a) **GOLDEN FIBRE LTD. producing Jute goods wants to participate in the 'Swatch Bharat Mission' of Government of India. Discuss about the social commitment of the corporate towards Environment pollution control and the treatment of costs as per CAS-14.**

b) **The following particulars pertaining to product AA are extracted from the record of SHIVAM LTD. for the half year ended March 31, 2018.**

c)

	Amount in ₹ Thousand
Direct Material Cost	975
Direct Wages and Salaries	250
Indirect Materials	85
Direct Expenses	150
Factory overheads	300
Administrative overheads	200
(20% relating to production activities)	
Quality Control Cost	75
Research and Development Cost	100
Selling and Distribution Expenses	25
Sale of Scrap realised	40
Material Cost includes Excise duty paid	75
Actual Profit Margin	10%
You are required to determine:	

The Cost of production for purpose of CAPTIVE CONSUMPTION in terms of Rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules 2000 and as per CAS-4 and Also Assessable value for the purpose of paying excise duty on Captive Consumption.

Answer:

4. **(a)** As per cas-14, pollution control means the control of emissions and effluents into environment. It constitutes the use of materials, processes, or practices to reduce, minimize, or eliminate the creation of pollutants or wastes. It includes practices that reduce the use of

toxic or hazardous materials, energy, water, and / or other resources. Pollution is thus a kind of interference to the environment degradation. The problems of such environmental degradation - air, water, noise pollution, solid wastes, radiation hazards, thermal pollution, are threats to wildlife, depletion and destruction of natural resources, etc. Are all environmental crisis and threats affecting the delicate balance of natural ecosystem?

The company producing jute goods belongs to low income labour intensive industry. The workforce re -sides in and around the factory premises. The level of pollution varies with the density of population and per capita income and inversely with the extent of recycling, technology and waste treatment. The different types, cause and effects of environmental pollution may be in the nature of

1) **Air pollution:** Which is the human introduction into the atmosphere of chemicals, particulates or biological materials that cause harm or discomfort to humans or other living organisms or damage the environment,
2) **Water pollution:** Due to unsanitary way of living, there is the contamination of water bodies. Water pollution affects public health and safety, causes damage to property and leads to many economic losses,
3) **Smell pollution:** Discharge of human soils openly, unclear garbage dumps, open sewers, etc. Affect physical well-being and even causes psychological disorders.

Swatch Bharat Mission is a comprehensive rural sanitation program launched by government of India and many corporate have supported construction of new toilets as a part of corporate social responsibility commitment enjoined in the companies act, 2013. Any expenditure on this account amount to 'social costs of pollution control' and the treatment of such costs are outlined in cas 14 as follows:

- Social costs of pollution are measured by economic models of cost measurement. The cost statement shall carry a reference to a descriptive note dealing with the social cost of pollution caused by the entity and the control of such pollution.
- Where the pollution control cost is not directly traceable to cost object, it shall be treated as overhead and assigned based on either of the principles of (i) cause and effect (ii) benefits received.
- Where estimates are made of future costs to be incurred on pollution control, the basis of estimate shall be disclosed separately.

(b) SHIVAM LTD. Computation of cost of production (As per -CAS-4)

(Amount in ₹ Thousand)

Direct materials (exclusive of excise duty) (975-75)	900
Direct wages & salaries	250
Direct expenses	150
Factory overheads (300+85)	385
Quality control cost	75
Research and development cost	100
Administrative overheads (to the extent relates to Production activity)	40
Less: Sale of scrap realized	(40)
Cost of production	**1860**
Add: 10% as per Rule 8 of CEV (DPOEG) Rules (10% of 1860)	186
Assessable value as per Rule 8 of the Valuation Rules	**2046**

Note:

i) Indirect materials have been included in Factory Overheads.

ii) Actual profit margin earned is not relevant for excise valuation.

5.

a) How to treat Inward Transportation Cost as per the Cost Accounting Standard 5?

b) How Transportation Cost is to be determined in case the manufacturer is having its own transport fleet?

c) What disclosures are required to be made in Cost statement as per CAS-8 as regards to utility?

Answer:

5. (a) As per the Cost Accounting Standard 5, Inward transportation cost is the transportation expenses incurred in connection with the materials/goods received at factory or place of use. Inward transportation costs shall form the part of the cost of procurement of materials which are to be identified for proper allocation/apportionment to the materials/ products.

(b) In case of a manufacturer having his own transport fleet, proper records shall be maintained to determine the actual operating cost of vehicles, showing the details of various elements of cost, such as salaries and wages of driver, cleaners and others, cost of fuel, lubricant, grease, amortised cost of tyres and battery, repairs and maintenance, depreciation of vehicles, distance covered and trips made, goods hauled transported to the depot. Separate records should be maintained as per Appendix 1 to the standard separately for

a. Inward transportation
b. Outward transportation
c. Movement for home consumption and export
d. Separate for production and trading activities
e. Separate for transportation other than by road, viz., by air, etc.

(c) Disclosures in cost statements as regards to Utility as per CAS-8 are as follows-:

- The basis of distribution of Cost of Utility to the consuming centres.
- The cost of purchase, production, distribution, marketing and price with reference to sales to outside parties.
- Where cost of utilities is disclosed at standard cost, the price and usage variances.
- The cost and price of Utility received from/supplied to related parties.
- The cost and price of Utility received from/supplied as inter unit transfers and intercompany transfers
- Cost of utilities incurred in foreign exchange.
- Any Subsidy/Grant/Incentive and any such payment reduced from Cost of utilities.
- Credits/recoveries relating to the Cost of utilities.
- Any abnormal cost excluded from Cost of utilities.

Penalties and damages paid etc excluded from cost of utilities.

Study Note – 6

OVERVIEW OF COST AUDITING STANDARDS

Learning Objective: *This chapter discusses the Cost Accounting Standards. Cost Accounting Standards are designed to achieve uniformity and consistency in the cost accounting principles and to establish regulations and also to follow the disclosed practices consistently and to comply with promulgated cost accounting standards.*

1. Choose the correct option among four alternative answers and justify your answer:

(I) Cost Auditing Standards deals with the __________ of the cost auditor.
- (a) Efficiency
- (b) Effectiveness
- (c) Qualifications
- (d) Responsibility

(II) Cost auditing standards, preface to the standards on auditing, quality control review and related services rendered by the cost accountant has been issued by _________.
- (a) ICAI
- (b) ICMAI
- (c) CAASB
- (d) ICWAI

(III) The Cost Auditing Standard 101 deals with __________.
- (a) Cost Audit Documentation
- (b) Planning an audit of Cost Statements
- (c) Knowledge of business, its processes and the business
- (d) Overall objectives of the independent cost auditor

(IV) Requirements of CAS – 104, the cost auditor shall _______________.
- (a) Comply with the relevant ethical requirements
- (b) Have adequate level of understanding of the knowledge of business
- (c) Prepare audit documentation
- (d) None of the above.

(V) The procedures followed by the cost auditor to reduce the audit risk to an acceptable level will not detect a misstatement that exists and that could be material is ____________.

(a) Inherent risk.

(b) Detection risk.

(c) Control risk.

(d) None of the above.

Answer:

1. **(I)** (d) Responsibility

(II) (c) CAASB

While formulating the Standards, the Cost Audit & Assurance Standards Board [CAASB] takes into consideration the applicable laws, usage and business environment prevailing in India. CAASB also takes into account the relevant provisions of Cost and Works Accountants Act, Rules and Regulations, Code of Professional Ethics, Cost Accounting Standards and other Statements issued by the Institute of the Cost Accountants of India.

(III) (b) Planning an audit of Cost Statements

Cost Auditing Standard 101 deals with the auditors' responsibility to plan an audit of cost statements, records and other related documents. The auditor shall prepare and document the overall audit strategy and audit plan.

(IV) (b)Have adequate level of understanding of the knowledge of business

In performing an audit of cost statement, records and other related documents, the cost auditor should have the knowledge of the client's business to enable him to understand the processes and express his opinion on the cost statements.

(V) (b) Detection risk.

"Detection risk" is the risk that the cost auditor will not detect a misstatement that exists in an assertion that could be material, either individually or when aggregated with other misstatements. Detection risk is a function of the effectiveness of an audit procedure and of its application by the auditor.

2.

(a) What is the difference between Cost Accounting Policy and Cost Accounting System?

(b) What constitutes the cost records under Rule 2(e)?

Answer:

2. (a) Cost Accounting Policy of a company state the policy adopted by the company for treatment of individual cost components in cost determination.

The Cost Accounting system of a company, on the other hand, provides a flow of the cost accounting data/information across the activity flow culminating in arriving at the cost of final product/service.

(b) As per Rule 2(e) the Companies (Cost Records and Audit) Rules, 2014, "cost records" means 'books of account relating to utilization of materials, labour and other items of cost as applicable to the production of goods or provision of services as provided in section 148 of the Act and these Rules'. There cannot be any exhaustive list of cost accounting records. Any transaction - statistical, quantitative or other details - that has a bearing on the cost of the product/activity is important and form part of the cost accounting records.

Cost records are to be kept on regular basis to make it possible to "calculate per unit cost of production/ operations, cost of sales and margin for each of its products for every financial year on monthly/quarterly/half-yearly/annual basis". What is required is to maintain such records and details in a structured manner on a regular basis so that accumulation is possible on a periodical basis.

3. (a) Who can be appointed as a cost auditor?

(b) What is the procedure for appointment of cost auditor under the Companies Act, 2013?

Answer:

3. (a) Only a Cost Accountant, as defined under section 2(28) of the Companies Act, 2013, can be appointed as a cost auditor. Clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 defines "Cost Accountant". It means a Cost Accountant who holds a valid certificate of practice under sub-section (1) of section 6 of the Cost and Works Accountants Act, 1959 and is in whole-time practice. Cost Accountant includes a Firm of Cost Accountants and a LLP of cost accountants.

(b) The cost auditor is to be appointed by the Board of Directors on the recommendation of the Audit Committee, where the company is required to have an Audit Committee. The cost auditor proposed to be appointed is required to give a letter of consent to the Board of Directors. The company shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of thirty days of the Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in form CRA-2, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

Any casual vacancy in the office of a cost auditor, whether due to resignation, death or removal, shall be filled by the Board of Directors within thirty days of occurrence of such vacancy and the company shall inform the Central Government in Form CRA-2 within thirty days of such appointment of cost auditor.

4. (a) What is the procedure to be followed for fixing the remuneration of a cost auditor?

(b) The Companies Act, 2013 has introduced provision regarding rotation of auditors. Is the provision of rotation of auditors applicable to cost auditors also?

Answer:

4. (a) Rule 14 of the Companies (Audit and Auditors) Rules, 2014 has laid down the procedure of appointment and fixing the remuneration of a cost auditor. It states as follows:

Remuneration of the Cost Auditor: For the purpose of sub-section (3) of section 148,—

(a) in the case of companies which are required to constitute an audit committee—

(i) the Board shall appoint an individual, who is a cost accountant in practice, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee, which shall also recommend remuneration for such cost auditor;

(ii) the remuneration recommended by the Audit Committee under (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;

(b) in the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant in practice or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.

(b) The provisions for maintenance of cost accounting records and cost audit are governed by Section 148 of the Companies Act, 2013. The provisions of Section 148 clearly states that no person appointed under Section 139 as an auditor of the company shall be appointed for conducting audit of cost records of the company. Section 148 also provides that qualifications, disqualifications, rights, duties and obligations applicable to auditors (financial) shall apply to a cost auditor appointed under this section. The eligibility, qualifications and disqualifications are provided in Section 141 of the Act and powers and duties are provided in Section 143. Section 143(14) specifically states that the provisions of Section 143 shall mutatis mutandis apply to a cost auditor appointed under Section 148. There are no other provisions governing the appointment of a cost auditor.

Section 139(3) of the Act, applicable to appointment of auditors (financial), and Rule 6 of Companies (Audit and Auditors) Rules, 2014 deals with the provision of rotation of auditors and these provisions are applicable only to appointment of auditors (financial). The Act does not provide for rotation in case of appointment of cost auditors and the same is not applicable to a cost auditor. It may, however, be noted that though there is no statutory provision for rotation of cost auditors, individual companies may do so as a part of their policy, as is the practice with Public Sector Undertakings.

5. (a) What are the duties of the Companies in relation to provisions of Section 148 of the Companies Act, 2013 and the Rules framed thereunder?

(b) A company has units in SEZ and in non-SEZ areas. The Companies (Cost Records and Audit) Rules 2014 has exempted companies operating in special economic zones from cost audit. What would be applicability of the Companies (Cost Records and Audit) Rules 2014 on such a company in respect of maintenance of cost accounting records and cost audit?

Answer:

5. (a) Every company required to get cost audit conducted under Section 148(2) of the Companies Act, 2013 shall:-

(a) Appoint a cost auditor within one hundred and eighty days of the commencement of every financial year;

(b) Inform the cost auditor concerned of his or its appointment;

(c) File a notice of such appointment with the Central Government within a period of thirty days of the Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in form CRA-2, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014;

(d) Within a period of thirty days from the date of receipt of a copy of the cost audit report, furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein, in form CRA-4 along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014.

(b) Rule 3 of the Companies (Cost Records and Audit) Rules 2014 is specific and it has mandated maintenance of cost accounting records on all products/activities listed under Table-A and Table-B subject to threshold limits. No exemption is available to any company from maintenance of cost accounting records once it meets the threshold limits. Hence, the above company would be required to maintain cost accounting records for all its units including the one located in the special economic zone.

In view of the provisions of Rule 4(3)(ii) of the Companies (Cost Records and Audit) Rules 2014 the unit located in the special economic zone would be outside the purview of cost audit and the company would not be required to include particulars of such unit in its cost audit report. The other units of the company located outside the special economic zone would be covered under cost audit subject to the prescribed threshold limits.

6. (a) What is the objective of Cost Auditing Standard – 102?

(b) Discuss about the nature and purpose of Cost Audit Documentation.

Answer:

6. (a) Cost Auditing Standard – 102 deals with the cost auditor's responsibility to prepare audit documentation for the audit of cost statements, records and other related documents. The specific documentation requirements of other Cost Auditing Standard's do not limit the application of this Cost Auditing Standard. Laws or regulations may establish additional documentation requirements.

The objective of this Standard is to guide the members to prepare documentation that provides:

(a) A sufficient and appropriate record of the basis for the Cost Auditor's Report; and

(b) Evidence that the audit was planned and performed in accordance with Cost Auditing Standards and applicable legal & regulatory requirements.

(b) The purpose of the Cost Auditing Standard – 102 is to provide guidance to the members in preparation of Audit Documentation in the context of the audit of cost statements, records and other related documents.

Nature and Purpose of Cost Audit Documentation:

Cost Audit documentation that meets the requirement of this Cost Auditing Standard and the specific documentation requirements of other relevant Cost Auditing Standards provides:

(a) Evidence of the cost auditor's basis for a conclusion about the achievement of the overall objectives of the cost auditor; and

(b) Evidence that the cost audit was planned and performed in accordance with Cost Auditing Standards and applicable legal and regulatory requirements.

Cost Audit documentation serves a number of additional purposes, including the following:

(a) Assisting the audit team to plan and perform the cost audit.

(b) Assisting members of the audit team responsible for supervision to direct and supervise the cost audit work, and to discharge their review responsibilities.

(c) Enabling the audit team to be accountable for its work.

(d) Retaining a record of matters of continuing significance to future cost audits.

(e) Enabling the conduct of quality control reviews in accordance with the Guidance Manual for Audit Quality issued by Quality Review Board (QRB).

(f) Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

7. (a) What is the objective of Cost Auditing Standard – 101?

(b) Discuss about the requirements of Cost Auditing Standard – 103.

Answer:

7. (a) The Cost Auditing Standard – 101 deals with the auditors' responsibility to plan an audit of cost statements, records and other related documents. The auditor shall prepare and document the overall audit strategy and audit plan.

The objective of this Standard is to guide the members in planning for the audit of cost statements so that it is performed in an efficient and effective manner. Audit planning shall also include establishing the overall audit strategy and audit plan for the conduct of the audit.

(b) The Cost Auditing Standard – 103 deals with the overall objectives of the independent cost auditor, the nature and scope of a cost audit, the independent auditor's overall responsibilities when conducting an audit of cost statements in accordance with Cost Auditing Standards. It also explains the requirements establishing the general responsibilities of the independent auditor applicable in all audits, including the obligation to comply with the Cost Auditing Standards.

The requirements of Cost Auditing Standard – 103 are given below:

(a) The cost auditor shall comply with the relevant ethical requirements including those pertaining to independence in respect of cost audit engagements
(b) While conducting an audit, the cost auditor shall comply with each of the Cost Auditing Standards relevant to the audit.
(c) The cost auditor shall have an understanding of the entire text of the Cost Auditing Standard, including its application and other explanatory material, to understand its objectives and to apply its requirements properly.
(d) The cost auditor shall plan and perform an audit with an attitude of professional skepticism recognizing that circumstances may exist that cause the Cost Statements to be materially misstated.
(e) The auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion.
(f) The cost auditor shall determine whether the Cost Reporting Framework followed by management in preparing cost statements is in line with the Companies Act and the Rules prescribed there under.
(g) The cost auditor shall not be required to perform audit procedures regarding the entity's compliance with laws and regulations governing cost audit in the absence of identified or suspected non-compliance.

(h) If an objective in a relevant Cost Auditing Standard cannot be achieved, the auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and thereby requires the auditor, in accordance with the Cost Auditing Standards, to modify the auditor's opinion.

8. Write short notes on:

(a) Risk assessment

(b) Risk of Material misstatement

(c) Audit and Ethics

(d) Conduct of audit

Answer:

8. (a) Risk assessment:

The audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the overall cost statement level and at the assertion level including items of cost, cost heads and disclosure thereof.

The cost auditor shall obtain an understanding of whether the entity has a process for:
(1) Identifying business risks relevant to cost reporting objectives;
(2) Assessing the likelihood of their occurrence;
(3) Estimating the significance of the risks; and
(4) Deciding about actions to address those risks

(b) Risk of material misstatement:

Audit risk is a function of the risk of material misstatement and detection risk. The risk of material misstatement has two components viz. Inherent Risk and Control risk.

(1) **Inherent risk:** the susceptibility of an assertion about the measurement, assignment or disclosure of cost to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

(2) **Control risk:** the risk that a misstatement that could occur in an assertion about the measurement, assignment or disclosure of cost and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entities internal, operational and management control.

The cost auditor shall identify and assess the risks of material misstatement at the cost statement level; and at the assertion level including items of cost, cost heads and disclosures thereof.

For this purpose, the cost auditor shall:

(1) Identify risks including relevant controls that relate to the risk of material misstatements or a risk of fraud;
(2) Assess whether the risk is related to recent significant economic, accounting or other developments and, therefore, requires specific attention;
(3) Assess whether the risk involves significant transactions with related parties;
(4) Assess the degree of subjectivity in the measurement of information related to the risk.
(5) Assess whether there arises a need for revising the assessment of risk based on additional audit evidence obtained

(c) Audit and Ethics:

The cost auditor should comply with relevant ethical requirements as per Code of Ethics issued by the Institute of Cost Accountants of India. This code establishes fundamental principles of professional ethics relevant to the auditor while conducting an audit and provides a conceptual framework for applying these principles. The fundamental principles with which the auditor is required to comply are Independence, Integrity, Objectivity, Professional competence and due care, Confidentiality and Professional conduct. In case of an audit engagement, it is in the public interest that the auditor should be independent of the entity subject to the audit. The cost auditor's independence from the entity safeguards the cost auditor's ability to form an opinion without being affected by influences that might compromise that opinion. Independence enhances the auditor's ability to act with integrity to be objective and to maintain an attitude of professional skepticism.

(d) Conduct of audit:

(a) The Cost Auditing Standards provide the standards for the cost auditor's work in fulfilling the overall objectives of the cost auditor. The Cost Auditing Standards deal with general responsibilities of the cost auditor, as well as cost auditors further considerations relevant to the application of those responsibilities to specific topics.

(b) In performing an audit, the cost auditor may be required to comply with legal or regulatory requirements in addition to Cost Auditing Standards. In such cases in addition to complying with each of the Cost Auditing Standard relevant to the cost audit, it may be necessary for the cost auditor to perform additional audit procedures in order to comply with the legislative and regulatory requirements. The Cost Auditing Standards do not override law or regulations that govern audit process.

The form of the cost auditor's opinion will depend upon the applicable cost reporting framework and any applicable laws or regulations such as Companies Act and Rules prescribed there under.

The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective in achieving the aim of the requirement.

Study Note – 7

FILING OF COST AUDIT REPORT TO MCA [In XBRL format (as per Taxonomy)]

Learning Objective: *Every Cost Auditor or every Lead Cost Auditor on behalf of all the Cost Auditors in a Company, has to file their Cost Audit Report and other documents with the Central Government as per sub-section (4) of section 233B of the Act, and rules made there under. Companies operating in the above mentioned industries and meeting the g criteria, should have cost auditors to conduct their cost records and file in XBRL format and those are discussed in the chapter.*

1. Choose the correct option among four alternative answers and justify your answer:

(I) XBRL technical term for a table

a) Hypercube
b) Imputed Value
c) Fact
d) Item

(II) XBRL is a language based on

a) XBL family of languages.
b) XRL family of languages.
c) XML family of languages
d) XGL family of languages.

(III) In XBRL Format process of determining the elements that correspond to lines and columns in a financial statement and which elements must be created by extension is:

a) Mapping
b) Label
c) Hierarchy
d) Scaling

(IV) Within a period of __________ days, company shall file a copy of the cost audit report to the Central Government.

a) 30 days
b) 45 days
c) 60 days
d) 90 days

(V) The length of Corporate Identity Number (CIN) is __________.

a) 13
b) 15
c) 21
d) 24

(VI) The length of Service Request Number (SRN) is __________.

a) 8
b) 9
c) 10
d) 11

(VII) The length of Permanent Account Number (PAN) is __________.

a) 9
b) 10
c) 11
d) 12

(VIII) _____________ of the Annexure to the Cost Audit Report of Companies (Cost Records and Audit) Rules, 2014 indicates the details of Quantitative Information.

a) Part A, Para 1
b) Part A, Para 2
c) Part A, Para 3
d) Part A, Para 4

(IX) In form ___________, company shall file the cost audit report to Central Government.

a) CRA-1
b) CRA-2
c) CRA-3
d) CRA-4

(X) Once the instance document is successfully validated from the tool, the next step is to ________.

a) download XBRL validation tool
b) pre-scrutinize the validated instance document
c) Convert to PDF and verify the contents of the instance document
d) attach instance document to the Form CRA-4

Answer:

1. (I) (a) Hypercube.

This is as per XBRL glossary of terms. Several technical terms are used, that have specific meanings, in the context of using XBRL.

(II) (c) XML family of languages

XBRL belongs to Extensible Markup Language family. It has been defined specifically to meet requirements of business and financial information

(III) (a) Mapping.

This is as per XBRL glossary. Several technical terms are used, that have specific meanings, in the context of using XBRL.

(IV) (a) 30 days

Rule 6(6), of the Companies (Cost Records and Audit) Rules, 2014, as amended by the Companies (Cost Records and Audit) Amendment Rules, 2016, within a period of thirty days, company shall file a copy of the cost audit report to the Central Government.

(V) (c) 21

Corporate Identity Number or Company Identification Number (CIN) is a unique 21 digit alpha-numeric number which is assigned by the ROC (Registrar of Companies).

(VI) (b) 9

A Service Request Number (SRN) is nine character alphanumeric strings, which starts with a letter followed by eight numerical numbers. Companies who have filed multiple Form 23C in respect of multiple cost auditors will be required to provide the SRN Numbers against each Form 23C filed.

(VII) (b) 10

Permanent Account Number (PAN) is a ten-digit alphanumeric number, issued by the Income Tax Department of India. PAN is unique to an individual or entity and it is valid across India.

(VIII) (d) Part A, Para 4

Part-A, Para 4 of the Annexure to the Cost Audit Report of Companies (Cost Records and Audit) Rules, 2014 require reporting of Net Operational Revenue of every CETA Heading separately comprised in the Total Operational Revenue as per Financial Accounts. The quantitative information and abridged cost statements will have to be provided for each unique combination of CETA Heading and UOM of the Products which are covered under cost audit.

(IX) (d) CRA-4

Rule 6(6), of the Companies (Cost Records and Audit) Rules, 2014, as amended by the Companies (Cost Records and Audit) Amendment Rules, 2016, within a period of thirty days, company shall file a copy of the cost audit report to the Central Government, in Form CRA-4 in XBRL format.

(X) (b) pre-scrutinize the validated instance document

Once the instance document is successfully validated from the tool, the next step is to pre-scrutinize the validated instance document with the help of the same tool using a working internet connection.

2. (a) What is XBRL?

(b) What are the steps to be followed to file the Cost Audit Reports in XBRL Format?

Answer:

2. (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.

(b) 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.
(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.

3. (a) How can the cost audit report and compliance report is converted into the XBRL format?

(b) Write a short note on creation of XBRL Instance document?

Answer:

3. (a) XBRL (Extensible Business Reporting Language) is an open source technology. Any of the following methods can be adopted to create the instance document required for filing of the respective reports.

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

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

(b) Creation of XBRL instance document

The first step for creating the instance document is tagging of the XBRL taxonomy elements with the information in the Cost audit report of the company by means of mapping of the taxonomy elements with the Cost audit report. This converts the report into XBRL form. We need to have a tool to create and xml file and convert it into an instance document. There are several vendors, who provide sell this application, that has to be acquired for the purpose.

Mapping is the process of comparing the concepts in the Cost audit report to the elements in the published taxonomy, assigning a taxonomy element to each costing concept published by the company. Once the tagging of Cost audit report/ compliance report elements with the published taxonomy elements is done, the next step is to create the instance document. An instance document is a XML file that contains business reporting information and represents a collection of costing information and report-specific information using tags from the XBRL taxonomy. It is to be noted that no extensions to the core Taxonomy will be allowed. Separate instance documents need to be created for the Cost Audit report, for the periods prior to and beginning after 1.04.2014.

Once the instance document has been prepared, it needs to be ensured that the instance document is a valid instance document and all the information has been correctly captured in the instance document. MCA Validation Tool provides for 'human readable' PDF printable form as well as a view of the instance document.

Study Note – 8

MANAGEMENT REPORTING ISSUES UNDER COST AUDIT

Learning Objective: *A statement of the company's financial position, such as Capital employed, Net worth, Profit before tax and ratio in terms of value and as percentage for the company sales, operating profit, value addition as a whole and for the product under reference, current ratio, debt-equity ratio, stocks of raw materials, stores & spares, WIP and finished goods in terms of number of months of consumption, production cost and cost of sales and also an analysis of expenditures restated in terms of costs per unit of output are discussed in the chapter under management reporting issues under cost audit.*

1. Choose the correct option among four alternative answers and justify your answer:

(I) Costing Taxonomy is best defined as a
a) Dictionary
b) Made easy
c) Tax Ready Reckoner
d) Reference

(II) Which one of the following is covered under performance analysis report?
a) Cost per unit of material used
b) Cost of utilities
c) Impact of IFRS on the Cost Structure
d) Impact of CAS and GACAP

(III) The Bureau of Energy Efficiency formed Under _______________
a) The Companies Act, 2013
b) The Energy Conservation Act, 2001
c) The Income Tax Act, 1961
d) None of the above

(IV) Activity based costing is used for the purpose of ____________
a) Cost Computation
b) Cost Reduction
c) Cost Control
d) Total performance management

(V) Performance pyramid is basically used for the purpose of ___________
a) Cost Computation
b) Cost Reduction
c) Cost Control
d) Total performance management

(VI) Life cycle costing is used for the purpose of ___________
a) Cost Reduction
b) Pricing and decision making
c) Total performance management
d) Cost Control.

(VII) Quality costing is used for the purpose of ___________
a) Cost Reduction
b) Pricing and decision making
c) Total performance management
d) Cost Control.

(VIII) KPI can be classified in the following Category _______________.
a) Quantitative & Qualitative
b) Actionable
c) Trending
d) All of the above

(IX) Which one of the following KPI is used to measure productivity & efficiency of a machine?
a) % of Idle time to total available time
b) Machine downtime ratio
c) Cost per of Break-Down Hour
d) Contribution per unit of material used.

(X) Financial Position and Ratio Analysis information in Annexure to Cost Audit Report to be provided for:
a) Current Year and Previous Year
b) Current Year and Previous 2 Years
c) Current Year and Previous 3 years
d) Current year only.

Answer:

1. **(I)** (a) Dictionary.

Costing Taxonomy is a dictionary of all cost elements required in cost audit report.

(II) (c) Impact of IFRS on the Cost Structure.

The Report on Performance Analysis may include the following.

(i) Manpower Analysis
(ii) Impact of IFRS on the Cost Structure, Cash-Flows and Profitability
(iii) Application of Management Accounting Tools etc.

(III) (b) The Energy Conservation Act, 2001

The Bureau of Energy Efficiency formed under the Energy Conservation Act 2001. The agency's function is to develop programs which will increase the conservation and efficient use of energy in India.

(IV) (a) Cost Computation

Activity based costing is a management accounting tool which is used to measure cost computation.

(V) (d) Total performance management.

Performance Pyramid is a management accounting tool which is used to measure total performance of organization.

(VI) (b) Pricing and decision making

Life cycle costing is a management accounting tool which is used for the purpose of pricing and decision making of the organization.

(VII) (a) Cost Reduction

Quality costing is a management accounting tool which is used for the purpose of cost reduction of the organization.

(VIII) (a) All of the above

The KPIs could be:

(i) Quantitative – these can be financial or non-financial
(ii) Qualitative – these are often lead indicators i.e. they influence future performance
(iii) Actionable – those which can be influenced by enterprise actions or controllable
(iv) Trending – those which need to be assessed over a period of time to observe whether they are improving or not.

(IX) (b) Machine downtime ratio

It is a ratio which indicates the efficiency and productivity of a machine. So, it is a key performance indicator to measure performance of a machine.

(X) (a) Current Year and Previous Year

This is pursuant to Rule 6(4) of the Companies (Cost Records and Audit) Rules, 2014

2. (a) What is meant by Performance Analysis?

(b) State the objective of preparing the Performance Analysis Report.

Answer:

2. (a) Performance measures help managers to create capable and matured processes. Measures are a tool to help understand, manage, and improve the performance of the organization as a whole. Effective performance analysis helps to:

(i) Monitor performance to judge how well the company is fairing,

(ii) Know if company management is meeting its goals.

(iii) If appropriate actions have been taken to affect performance or improve efficiency if improvements are necessary.

The Report on Performance Analysis may be submitted to the Board of Directors of the Company, the performance measures which will be appraised should be discussed with the Company Management and then finalized for analysis and reporting thereof.

(b) The basic objective to prepare a Report on Performance Analysis is to provide an actionable insight into costs and profitability for the management in the strategic and operational context. It aims at discovering various drivers of costs and profitability and their impact on the selected performance variables. It would help the organisations:

(i) to improve profits and profitability

(ii) to optimize resource allocation

(iii) to optimize the product and services portfolio

The objective is to provide assessment of the performance of the organisation across various spectrums. It inter-alia aims at satisfying the goals of management audit. It is concerned with providing the Board with information that it "should know" to take suitable actions to improve business performance.

3. (a) Discus the steps suggested for the report on performance analysis?

(b) Indicate the contents of Performance Analysis Report?

Answer:

3. (a) Suggested below the steps involved in the preparation of report on Performance Analysis:

(i) Identify and understand the key strategies of the company, both prescriptive and emergent strategies included.

(ii) Choose strategies that have more visible expressions in costs data maintained by the company.

(iii) Identify the activities that were impacted by the strategies selected and also implemented during the year.

(iv) Analyze the cost implications of those activities and link it with the expected results of the strategies.

(v) Present the evaluation, in a table or any other easily comprehensible format like histogram, chart, graph etc.

(vi) Give explanatory notes for the terms used, calculations made, and assumption behind the evaluations.

(vii) Finalize the finding after a discussion with the concerned operating executives and then with the management of the company.

(b) The Report on Performance Analysis may cover the following indicative areas:

(i) Capacity Utilization Analysis

(ii) Productivity/Efficiency Analysis

(iii) Utilities/Energy Efficiency Analysis

(iv) Key-Costs & Contribution Analysis

(v) Product/Service Profitability Analysis

(vi) Market/Customer Profitability Analysis

(vii) Working Capital & Inventory Management Analysis

(viii) Manpower Analysis

(ix) Impact of IFRS on the Cost Structure, Cash-Flows and Profitability

(x) Application of Management Accounting Tools

For these and any other performance measures elected for inclusion in the Report on Performance analysis, the auditor should also include wherever appropriate the following:

(i) Horizontal and vertical analysis of quantitative figures
(ii) Trend analysis of performance parameters reflecting 3-10 years' figures
(iii) Qualitative comments with interpretations of the cost auditor
(iv) Comparison with external benchmarks such as industry average

4. a) What do you mean by Management Accounting Tool?

b) Discuss about the various management accounting tools which are used to serve for different objectives.

Answer:

4. (a) The performance measurement involves collection of information, analyzing the same by establishing the inter-relations between them, interpreting the results and then arriving at meaningful conclusion. The collection of information depends upon various sources of data and other reports for various systems used by the organization.

The data input is generally made in the accounting system used by the company e.g. the ERP systems. Most of the ERP systems facilitate input and capturing of even the non-financial data which can be then processed to produce desired reports. There is a lot of information to be accessed from outside of the ERP system. The auditor should identify such sources within and outside of the organization and use information drawn from the same.

(b) The management accounting tools could be used to analyze the performance with different purposes. The auditor should verify the tools and techniques used by the company and comment on appropriateness and adequacy thereof. The auditor could recommend more appropriate management accounting tool

The following table shows various management accounting tools that are used to serve different objectives:

Purpose	Management Accounting tool
Control	Budgetary control, standard costing, variance analysis
Cost computation	Full(absorption) Costing, Job, batch, process or contract costing Activity based costing, Time Driven ABC
Cost reduction	Total Quality management, Quality costing, Kaizen costing, Lean manufacturing, Value Analysis and Value Engineering, Six Sigma

Pricing and decision making	Target costing, Life cycle costing, Throughput accounting, Variable or marginal costing
Total performance management	Balanced Scorecard, Performance Prism, Performance pyramid, Business Objects, Business Intelligence

The auditor should be acquainted with the intricacies of these and such other tools and what it takes to successfully implement and use them. The success of Report on Performance Analysis would depend upon not how many performance measure are considered, but upon how they are evaluated and assessed with the help of various management accounting tools.

5. Write short notes on:

a) Profitability Analysis
b) Key Performance Indicators (KPIs)
c) Utilities and energy efficiency analysis
d) Manpower Analysis

Answer:

5. (a) Profitability Analysis

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.

(b) Key Performance Indicators (KPIs)

Key Performance Indicators (KPIs) are simply the variables, independent or interdependent, in respect of which the goals can be set and performance measured to assess whether it is in furtherance of the enterprise objectives.

Hence, for evaluation of performance the selection of KPIs must be chosen correctly in tune with the objectives. The KPI measurement should not be a static computation, but always needs to be compared with a benchmark set. The KPIs could be:

- **Quantitative** – these can be financial or non-financial
- **Qualitative** – these are often lead indicators i.e. they influence future performance
- **Actionable** – those which can be influenced by enterprise actions or controllable
- **Trending** – those which need to be assessed over a period of time to observe whether they are improving or not.

(c) Utilities and energy efficiency analysis

This is an extended analysis of single factor productivity in respect of the utilities and energy inputs acquired and consumed by the company. The importance of conservation of non-renewable energy needs no emphasis.

The utilities are resources that are used in the process of conversion of material and other components into a finished product, but these resources do not form part of the physical unit of the product. In manufacturing industries, utilities and energy form a substantial part of the conversion cost.

The broad headings under which the utilities and energy performance could be categorized are Power, steam, electricity, compressed air, water, etc. These utilities are consumed in the production process or in environment protection initiatives. The use of utilities for administrative functions may be found in terms of lighting, cooling, ventilation, heating refrigeration etc. The auditor should evaluate the impact from cost angle as well as from the viewpoint of conservation of energy. It is essential to check if there are any statutory norms prescribed for the company.

For external benchmarking, it may be useful to refer to the practices followed by companies which are accredited by the Bureau of Energy Efficiency formed under the Energy Conservation Act 2001.

The performance appraisal parameters for energy and utilities would include the consumption of fuel for generating energy and then the use of the energy thus produced per unit of final product.

(d) Manpower Analysis

The depth of analysis of manpower could depend upon the proportion of manpower cost to the total cost of product or service. The performance criteria for this area will mainly be related to the costs and efficiency or productivity.

The costs may be categorized into the cost of recruitment, cost of maintaining the manpower and the cost of separations. Recruitments costs may include position advertisements, commission paid to recruitment agencies, participation in job fairs or campus recruitment etc. The maintenance costs may be the training & development costs, facilities provided over & above the monetary benefits etc. The separation costs would mostly be implicit costs. These costs as a percentage of the total salaries and wages would provide an insight into the quality of manpower management. These costs could be further broken up as per the hierarchies of people. The time taken to recruit important positions may affect the performance adversely.

The factor returns from the manpower is in terms of growth in production and productivity, enhancement of skills and knowledge of the organization. The auditor should analyse the figures of manpower productivity, idle time, overtime worked, absenteeism etc. These factors could be compared with the respective outputs such as increased production, increased sales etc. The criteria such as sales per person achieved, production per man hour etc. will add value to the Report on Performance Analysis.

Study Note – 9

BASICS OF MANAGEMENT AUDIT

Learning Objective: *This chapter discusses about Management Audit which involves the review of managerial aspects like organizational objective, policies, procedures, structure, control and system in order to check the efficiency or performance of the management over the activities of the Company.*

It goes beyond the conventional audit which involves a scrutiny of financial transactions and the books of accounts. It is a comprehensive and a critical review of all aspects of management.

1. Choose the correct option among four alternative answer and justify your answer:

(I) Management audit _______________ on financial matters.

a) Involves
b) Only concentrate
c) Does not concentrate
d) None of these

(II) The main objectives of management audit is to ________________.

a) Suggest improvement in methods of operations
b) Framing basic policies for the organisation
c) Setting up an organizational framework
d) None of these

(III) Management audit is the unique process of ________________ the performance of directors, managers or the performance of Management.

a) Appraising
b) Calculating
c) Auditing
d) Planning

(IV) The main emphasis of Management Audit:

a) Problem solving
b) Problem identification
c) Problem definition
d) Problem avoidance

(V) Management audit is normally presumed to be a _______________ into a performance of a manager or group of managers.

a) Routine investigation

b) Non-routine investigation

c) Auditing

d) None of these

Answer:

1.

(I) **(c) Does not concentrate**

(II) **(a) Suggest improvement in methods of operations**

(III) **(a) Appraising**

(IV) **(b) Problem identification. -** Management Audit pinpoints the areas requiring attention of management, it evaluates the existence of well defined objectives, it seeks to review appraise and evaluate the corporate plans and policies based on certain standards of objectivity.

(V) **(b) Non-routine investigation**

2.

a) Discus the scope of management audit?

b) State the essential qualities required of a Management Auditor.

Answer:

2. (a) The scope of management audit may include-

- The suitability, practicability and present compliance or otherwise of the organization with its desired objectives and aims.
- The current image of the organization among customers, general public within its own particular industrial or commercial field.
- Efficient utilization of resources of the organization.
- The rate of return of investors' capital- whether poor, adequate or above average.
- Relationship of the business with its own shareholders and investing public in general.
- Employee relationship

- The aims and effectiveness of management at its various levels such as top level, middle Level, and operational level.
- Financial policies and control relating to production, sales and distribution and in other functions of the organization.

(b) The essential qualities of a Management Auditor are:

1) Ability to grasp business problems.
2) Ability to determine or assist the progress of the organization.
3) Knowledge of the principles of delegation of authority and control and the preparation of different budgets.
4) Power of grasping and understanding different internal control devices.
5) General understanding of different laws.
6) Sufficient knowledge and experience in preparing various reports for submission to different levels of management including the top management.
7) Tactfulness, perseverance, pleasing and dynamic personality.

3.

a) What are the objective of management audit?

b) Discuss the concept of evidence in relation to Management Audit.

Answer:

3. (a) The objectives of management audit can be summarized as follows:-

- To ensure optimum utilization of all the resource employed, including money, materials, machines, men and methods;
- To highlight inefficiencies in objectives, policies, procedures and planning;
- To suggest improvement in methods of operations;
- To highlight weak links in organizational structure and in internal control systems, and suggest necessary Improvements;
- To help management by providing health indicators and help prevent sickness or help cure in case of Sickness; and
- To anticipate problems and suggest remedies to solve them in time.

(b) In management audit, there are no fixed items of evidence that has to be checked by the management audit or on routine basis. A management audit or has to rely more on his experience to identify the are as of review, particularly the are as of weakness to overcome, strengths to be exploited, and risks to be properly covered.

The auditor's evidence comes through his discussions with concerned persons in the organizations, survey and review of various reports like internal audit reports, inspection reports, physical verification, monthly performance review statements, minutes and notes and above all personal observations.

Evidence may be gathered through sampling techniques and on basis of results drawn, going into details where required. It should be understood that a management auditor does not depend on voucher as evidence, but shall fall back on various records including vouchers as evidence for his audit if sample demand so. The evidence should be such that an auditor can draw valid conclusions duly verifying the same with people concerned. There is no area of restrictions for obtaining evidence for a management auditor.

Study Note – 10

MANAGEMENT AUDIT IN DIFFERENT FUNCTIONS

Learning Objective: *Management Audit is a systematic examination of decisions and actions of the management to analyse the performance. Management audit involves the review of managerial aspects like organizational objective, policies. Management audit helps the manager of the internal audit function and tries to contribute to the overall continuous improvement of the organization in general.*

1. Choose the correct option among four alternative answer and justify your answer:

(i) Important point in Corporate planning is__________________

a. Time and Work Study
b. Imposing Control System
c. Forecasting and goal setting.
d. SWOT analysis.

(ii) Assurance engagements involve ______________

a. Only Individual Parties
b. Three separate parties.
c. Contractor and Contractee
d. None of them

(iii) The consumer service audit critically examines:

a. Outstanding payment of consumers.
b. Price consumers are ready to pay for particular product/service
c. An appraise management of business enterprise of responsibility towards consumers.
d. Demand of a product by consumers.

(iv) Consumer Service Audit is part of __________________

a. Business Activity Audit
b. Social Audit
c. Service Audit
d. None of Above

(v) There are no fixed items of evidence to be checked by Management Auditor

a. The statement is true.
b. The statement is false.
c. The statement is partly true.
d. The statement is partly false.

(vi) Management Audit Report Submitted to:

a. Cost Audit Branch
b. Audit Committee
c. Central Government
d. Management of Concern

(vii) There are no fixed items of evidence to be checked by Management Auditor. A Management Auditor has to rely more on ___________

a. his experience and acumen.
b. Auditors Working Paper.
c. Physical Verification Sheet.
d. Information Provided by Management.

(viii) Zero base budget(ZBB) system was modeled by _______________

a. Peter A. Woodcock.
b. Peter A. Phyrrh.
c. P F Ducker
d. None of them

(ix) Efficiency Audit ensures ____________ return on Capital Employed.

a. optimum
b. maximum
c. minimum
d. average

(x) Who is the developer of Management Audit.

a. T. G. Rose
b. T. G. Tailors
c. M. C. Sukla
d. None of them

Answer:

1. **(i) SWOT analysis**

   A SWOT - strengths, weaknesses, opportunities and threats analysis can help identify and understand key issues affecting the business.

   (ii) Three separate parties.

   The parties are a public accountant in practice, a responsible party and intended users.

   (iii) An appraise management of business enterprise of responsibility towards consumers.

   The audit is based on the philosophy that the role of business should be conducive to raising the quality of life through its contribution in terms of better product-quality and services by making available the products and services of the right qualities at the right time, in right quantity, at the right place and right price.

   (iv) Social Audit.

   Consumer Service Audit is an audit of public responsibility of business enterprise in relation to its customers and is a part of social audit. The audit is based on the philosophy that the role of business should be conducive to raising the quality of life through its contribution in terms of better product-quality and services.

   (v) The statement is true.

   A Management Auditor has to rely more on his experience and acumen to identify areas of review.

   (vi) Management of concern.

   Management audit undertakes examination of the effectiveness of management in controlling the total activities of the organization in the accomplishment of the organization objectives.

   (vii) his experience and acumen.

   A Management Auditor has to rely more on his experience and acumen to identify areas of review. There are no fixed items of evidence to be checked by Management Auditor.

   (viii) Peter A. Phyrrh.

   Zero base budget (ZBB) System was modeled by Peter A. Phyrrh.

(ix) Optimum.

The main purpose of Efficiency Audit is to ensure —

That every rupee invested in capital or in other fields give optimum returns, and

The balancing investment between different functions and aspects designed to give optimum results.

(x) T. G. Rose

T. G. Rose developed the concept of Management Audit as a logical system of evaluating the quality of Management.

2.

a) As a Management Auditor of a large organization, you have been asked to carry out the review of MARKETING POLICIES: as a part of Corporate Development. Prepare a questionnaire for carrying out such a review.

b) State the essential qualities required of a Management Auditor.

Answer:

2. (a) A questionnaire for review of 'Marketing Policies' of the company:

1) Consumer needs assessment –
   - ✓ Is the policy rationable in terms of marching customers' needs with the firm's offering and capabilities?
   - ✓ What is the likely consumer reaction?
   - ✓ What are the evaluation studies undertaken to assess consumer reaction, particularly, in respect of product features, price, distribution outlets, new product concept, new product introduction?

2) Market segmentation –
   - ✓ What is target market conceived?
   - ✓ Is market segmentation based on empirical data, such as-usage, demographic, benefits sought, consume characteristics etc.?

3) Competition and product position -
   - ✓ How many are competitive producers?
   - ✓ What is company's share in the total market?
   - ✓ How many competitors have left the market over the last few years?
   - ✓ What is the general competitive environment?
   - ✓ What particular product characteristics does the firm possess that contribute to the market place?
   - ✓ What is the relative market position of the products at different stages of their life cycle?

4) Marketing Mix-
   - ✓ How is the optimum mix of pricing, distribution and promotional policy for each of the products of firms determined?
   - ✓ What are the company's approaches to issue like product Design, products Positioning, Price-range, advertising and promotion media etc.?

5) Marketing programme
   - ✓ Is the marketing program of the company designed to emphasize lower price, mass distribution channels and mass advertising to reach numerous market segments?

6) Resource Allocation
   - ✓ Does the marketing program take into account the interdependencies among the various options and a resource allocation procedure to direct the company's commitment of resources among products, markets segments and the related marketing strategies to accomplish the objectives?
   - ✓ If so, how is the resource allocation procedure has been established for different marketing decisions?

(b) The Essential Qualities of a Management Auditor are:

(i) Ability to grasp business problems.

(ii) Ability to determine or assist the progress of the organization.

(iii) Knowledge of the principles of delegation of authority and control and the preparation of different budgets.

(iv) Power of grasping and understanding different internal control devices.
(v) General understanding of different laws.
(vi) Sufficient knowledge and experience in preparing various reports for submission to different levels of management including the top management.
(vii) Tactfulness, perseverance, pleasing and dynamic personality.

3.

a) What is meant by "Corporate Services Audit"?
Describe the areas of the "Corporate Services Audit", the scrutiny thereof and evaluation criteria used in the Audit.

b) You are appointed by Mr. K who wants to join DEF & Co., partnership firm as an investigating accountant. List out the steps involved in conducting the same.

Answer:

3. (a) With the enlarged role assumed by corporate organization in this country, the corporate bodies are expected to have better social responsibilities than in the past. The term "Corporate Services" refer to the activities that combine or consolidate certain enterprise- wide needed support services, provided based on specialized knowledge, best practices, and technology to serve internal (and sometimes external) customers and business partners viz. employees, shareholders, community, fellow businessman and Government. Management Auditor studies separately and properly, evaluate after critically examination of the different aspects of services and their extent that have been satisfactorily rendered by the corporate body and of evaluation of degrees of responsiveness and awareness on the part of such enterprise.

The areas of Corporate Service Audits are:

Consumers	-	Quality goods in right qualities at right price place and time.
Employees	-	Pay, training, safety, welfare, industrial relations, etc.
Shareholders	-	Safety of investment, satisfactory return, appreciation (in Value & Quantity & marketability)
Community	-	Social Cost and Social benefit public relations.
Fellow Businessmen	-	Business ethics and fair trade dealings.

State/Government - Compliance with, the spirit of laws, fair trade practices, payment of Taxes.

Auditor should consider the level of contribution a business entity makes to society and its business environment towards raising the quality of life through better product quality and services rather than profit maximization. So, it is an appraisal by the auditor as referred above and auditor's responsibilities lies in evaluating the company's response to social needs.

(b) The general approach of the investigating accountant in this type of investigation would be more or less similar, irrespective of the nature of business of the firm-manufacturing, trading or rendering a service. Primarily, an incoming partner would be interested to know whether the terms offered to him are reasonable having regard to the nature of the business, profit records, capital distribution, personal capability of existing partners, socio-economic setting, etc. and whether he would be capable for services to be rendered, which can be justified by the overall economic conditions prevailing and other considerations considering his own personality and achievements. In addition, he would be interested to ascertain whether the capital to be contributed by him would be safe and applied usefully. Broadly, the steps involved are as under:

a. Ascertaining the history of the firm since inception and growth of the firm.
b. Studies of the provisions of the Deed of Partnership, particularly for composition of partners, their capital contribution, drawing rights, retirement benefits, job allocation, etc.
c. Scrutiny of the record of profitability of the firm's business over a suitable number of years, with usual adjustments that are necessary in ascertaining the true record of business profits. Particular attention should, however, be paid to the nature and profitability of the business, qualification and expertise of the partners and such others as may be relevant.
d. Examination of the asset and liability position to determine the tangible asset, partners, investment, appraisal of the value of intangibles like goodwill, knowhow, patents, etc. impending liabilities including contingent liabilities and those for pending tax assessment.
e. Assess position of order at hand and the range and quality of clientele should be thoroughly examined under which the firm is presently operating.
f. Scrutinize terms of loan finance to assess its usefulness and the implication for the overall financial position.
g. Study important contractual and legal obligations should be ascertained and their nature studied. It may be the case that the firm has standing agreement with the employees as regards salary and wages, bonus, gratuity and other incidental benefits. Full import of such standing agreements would be gauged before a final decision is reached.

h. Study the composition and quality of key personnel employed by the firm and any likelihood of their leaning the organization.
i. Ascertain reasons for the offer of admission to a new partner and it should be determined whether the same synchronizes with the retirement of any senior partner whose association may have had considerable impact having on the firm's successes.
j. Appraisal of the record of capital employed and the rate of returns. It is necessary to have a comparison with alternative business avenues for investments and evaluation of possible results on a changed capital and organization structure.
k. Ascertain manner of computation of goodwill on admission as also on retirement, if any.

Examine whether any special clause exist in the Deed of Partnership to allow admission in fu1ture a new partner.

4.

a) Evaluation of the personnel function of an organization by management auditor is by no means an easy task. In your view what areas are to be covered and points to be kept in mind while assessing the personnel function of an organization?

b) While performing an Information System Audit, the Management Auditor should make sure that various objectives are met. Briefly describe them.

Answer:

4. (a) The personnel management is concerned with managing people at work for development of efficient and loyal employees for attainment of organization goals. So evaluation personnel function is not an easy task. The important areas to be covered by management auditor while evaluating personnel function are as follows:

(I) Methods followed for manpower planning, recruitment, training, promotion and transfers.
(II) Action plan for reducing absenteeism.
(III) Procedure for analysis of labour turnover and steps taken for reduction of the same.
(IV) Method adopted for developing wage and salary structure.
(V) Incentives plan –financial, i.e., bonus, increment etc. and non-financial e.g job enrichment, promotion etc.
(VI) Welfare and safety measures adopted including social security measures and community development programmes.

(VII) Performance appraisal system of the organization.
(VIII) Measures undertaken to boost employee morale.

The following points to be kept in mind while assessing the personnel function of an organization:

(I) It is difficult to exactly quantify the influence of human factors and its contribution to success or failure of the organization.
(II) Development of a uniform yard stick for measurement of performance of a large group of workers is also not easy.
(III) Workers get influenced by the overall industrial environment.
(IV) Motivating the employees towards achievement of organization goals is a very important as well as difficult task.
(V) The management auditor should assess whether the managers possess necessary leadership qualities and dynamic ideas to motivate their personnel.
(VI) The personnel function is a very important function because in the absence of a well-organized personnel function, the company will not be able to utilize the other resources in optimum manner. Human resource is the most important resource in any organization.

(b) While performing an Information System audit, Management Auditors should ascertain that the following objectives are met:

(i) Security provisions protect computer equipment's, programs, communications and data from unauthorized access, modification, or destructions.
(ii) Program development and acquisition is performed in accordance with management's general and specific authorization.
(iii) Program modifications have the authorization and approval of management.
(iv) Processing of transactions, files, reports and other computer records is accurate and complete.
(v) Source data that is inaccurate or improperly authorized is identified and controlled according to prescribed managerial policies.
(vi) Computer data files are accurate, complete and confidential.

5.

a) XYZ Ltd. engaged in manufacturing of engineering goods is consistently recording higher sales turnover, but declining net profits since the last 5 years. As an management consultant appointed to find out the reasons for the same, what are the points you would verify?

b) What do you understand by "Energy Audit"? Briefly state the functions of energy auditor.

Answer:

5. (a) As per the facts that there has been consistently high turnover but declining net profits is an anomalous situation. It may be attributed to one or more following reasons requiring further investigation:

(i) Unfavorable Sales mix: Where the company sells different engineering products with different product margins, the product with the maximum PV ratio/margin should have a higher share in the total sales. If due to revision of sales mix, more quantities of unprofitable products are sold, profits will be reduced inspite of an increase in sales.

(ii) Negative Impact of Financial Leverage: Where the company does not have sufficient own funds (equity) but has a higher debt-equity ratio, the interest commitments will be higher. As the volume of its operation increases, higher debt and interest charges would result in lower profits.

(iii) Other Items Included in Sales: The figure of sales as per Profit and Loss Account may include incidental revenues, e.g., freight, excise duty, sales-tax, etc. where the amount of excise duty goes up considerably the total sales may show an increase which is not represented by a real increase in sales quantity/value.

(iv) High Administrative and Selling Expenses: Administrative and selling costs are generally period costs which are fixed in nature. Their increase is generally not proportional to sale increase. However, a reduction in profit could also be due to increase in administrative overheads and sales overheads at a rate higher than the rate of increase in sales.

(v) Cost-Price Relationship: If the increases in cost of raw materials and labour has not been compensated by a corresponding increase in the sales price this would also result in higher sales and declining profits. Inspite of same sales quantity, for the increasing cost of raw materials and other services, per unit values of the product has been increased which is however unmatched by the increase in cost.

(vi) Competitive Price: Where sales have been made at cut-throat prices in order to eliminate competition from the market, the profits would be in the declined trend in the short-run.

(vii) Additions to Fixed Assets: Where there are heavy additions to fixed assets and consequent depreciation charges in the initial years of additions, there may be reduction in profits in spite of increased sales.

(b) Energy Audit is the key to a systematic approach for decision-making in the area of energy management. It attempts to balance the total energy inputs with its use, and serves to identify all the energy streams in a facility. It quantifies energy usage according to its discrete functions. Industrial energy audit is an effective tool in defining and pursuing comprehensive energy management programme.

As per the Energy Conservation Act, 2001, Energy Audit is defined as "the verification, monitoring and analysis of use of energy including submission of technical report containing recommendations for improving energy efficiency with cost benefit analysis and an action plan to reduce energy consumption".

In that context, energy management involves the basis approaches reducing avoidable losses, improving the effectiveness of energy use, and increasing 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 analyses 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.

6. Descriptive Questions:

a) What do you understand by ― Corporate Services Audit‖? Describe the areas of Corporate Services Audit, the scrutiny thereof and the evaluation criteria used in such audit.

b) Management Audit and Operational Audit are complementary and supplementary to one another". Discuss in brief.

Answer:

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

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

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

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

- ✓ **Consumers:** Quality of goods in right quantity, right price, right place and right time.
- ✓ **Employees:** Pay, Safety, Welfare and Industrial Relations etc.

- ✓ **Shareholders:** Safety of investment, satisfactory return and capital appreciation.
- ✓ **Community:** Social cost and social benefit, public relation
- ✓ **Fellow- businessmen:** Business ethics and fair trade dealings.
- ✓ **State:** Compliance with various legislations, fair trade practices, payment of taxes etc.

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

(b) Management Audit is wider in scope compared to Operational Audit.

Management Audit is concerned with quality of managing whereas Operational Audit centres on the quality of operation. Operational Audit is an audit for the management and Management Audit is an audit of the management also.

The basic difference between the two audits is not in method, but in the level of appraisal. In management audit, the auditor is to make his tests to the level of top management, its formulation of objectives, plans and policies and its decision making. It is not that he just verifies the operations of control and procedures and fulfillment of plans in conformity with the prescribed policies.

The auditor is to reach the root i.e., the functions of top management which lay down objectives and policies, provide means and procedures of implementation and control and which actually engage in direction and control on a continuous basis. In addition to what would normally be covered in an operational audit, management audit would also encompass the relevance and effectiveness of the aims, duties and decisions of management at various levels, plans, policies and decisions of the top management. Every aspect of the functions of Board of Directors should be in conformity with the objects set out in the constituting document. Similarly, the managing director, if any, should act not only in accordance with the mandate he has received but he should ensure that the decisions he takes are in conformity with the objects of the company and the policies formulated by the Board. The effectiveness of management under the control of managing director and the various members of the Board including those in charge of finance, production, sales etc., should be subject to review of the management auditor.

Therefore, it can be said that the two audits are complementary and supplementary to one another.

7.

a) Mr. Ram, being a CMA, certifies a financial forecast of his client which was forwarded to the client's bank based on which the bank sanctioned a loan to the client.

b) State four objectives of operational audit.

c) While performing an Information System Audit, the Management Auditor should make sure that various objectives are met. Briefly describe them.

Answer:

7. (a) Under Clause (3) of Part I of Second Schedule to the Cost and Works Accountants Act, 1959, a CMA in practice is deemed to be guilty of professional misconduct if he permits his name or the name of his firm to be used in connection with an estimate of cost or earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast. Accuracy does not refer to arithmetical accuracy. All forecasts are estimates based on certain assumptions duly evaluated on a consideration of various relevant factors and cannot be ascertained with accuracy. But, first of all, he should clearly indicate in his report the sources of information, the basis of forecasts and also the major assumptions made in arriving at the forecasts and, secondly, he should not vouch for the accuracy of the forecasts. In the instant case, CMA. Q is deemed to be guilty as it appears that he has certified the financial forecast without taking adequate safeguards.

(b) Generally, operational audit objectives include:

Appraisal of controls: The most significant gain an organization can derive from operational auditing is probably in the area of appraisal of controls.

a. Evaluation of performance: In performance appraisal, the operational auditor is basically concerned not so much with how well technically the operations are going on, but with accumulating information and evidence to measure the effectiveness, efficiency and economy with which the operations are being carried on.
b. Appraisal of objectives and plans: Operational auditor may look into the aspects like whether objectives are clearly spelt out and properly communicated to the personnel responsible for implementation and whether the personnel have understood the objectives in the sense meant by the management. Also, he can take note of any apparent conflict in the objectives for its effect on operations.
c. Appraisal of organizational structure: Organizational structure provides the line of relationships and delegation of authority and tasks. Therefore, this is also another important area for appraisal by the operational auditor.

(c) While performing an Information System audit, Management Auditors should ascertain that the following objectives are met:

a. Security provisions protect computer equipment, programs, communications and data from unauthorized access, modification, or destructions.

b. Program development and acquisition is performed in accordance with management's general and specific authorization.
c. Program modifications have the authorization and approval of management.
d. Processing of transactions, files, reports and other computer records is accurate and complete.
e. Source data that is inaccurate or improperly authorized is identified and controlled according to prescribed managerial policies.
f. Computer data files are accurate, complete and confidential.

8.

a) Discuss the concept of evidence in relation to Management Audit.

b) Write short note on - Probable format of environmental statement.

c) What points should you consider as an Management Auditor performing CSR Audit?

Answer:

8. (a) In management audit, there are no fixed items of evidence that has to be checked by the management auditor on routine basis. A management auditor has to rely more on his experience to identify the areas of review, particularly the areas of weakness to overcome, strengths to be exploited, and risks to be properly covered.

The auditor's evidence comes through his discussions with concerned persons in the organizations, survey and review of various reports like internal audit reports, inspection reports, physical verification, monthly performance review statements, minutes and notes and above all personal observations.

Evidence may be gathered through sampling techniques and on basis of results drawn, going into details where required. It should be understood that a management auditor does not depend on voucher as evidence, but shall fall back on various records including vouchers as evidence for his audit if sample demand so. The evidence should be such that an auditor can draw valid conclusions duly verifying the same with people concerned. There are no area of restrictions for obtaining evidence for a management auditor.

(b) The following are the main aspects which may be covered in the probable format of Environmental Statement:
a. Name and address of the owner/occupier of the industry, operation or process.
b. Date of last environmental audit report submitted.
c. Consumption of water and other raw materials during current and previous year.

d. Pollution generated in air and water along with the output and the types of pollutants and the deviation from standards.
e. Generation of hazardous waste in current year and previous year from processes.
f. Quantity of solid waste generated during current year and previous year and from recycling or reutilization of waste, etc.
g. Disposal practice for different type of waste.
h. Practice in operation for conservation of natural resources.
i. Additional investment proposal for environmental protection including abatement of pollution.

(c) The concept of CSR rests on the ideology of give and take. Companies take resources in the form of raw materials, human resources etc. from the society. By performing the task of CSR activities, the companies are giving something back to the society. India`s new Companies Act 2013 has introduced several new provisions which change the face of Indian corporate business. One of such new provisions is Corporate Social Responsibility (CSR).

A CSR audit program can cover all or any of the following risks: -

- ✓ Effectiveness of the operating framework for CSR implementation
- ✓ Effectiveness of implementation of specific, large CSR projects
- ✓ Adequacy of internal control and review mechanisms
- ✓ Reliability of measures of performance
- ✓ Management of risks associated with external factors like regulatory compliance, management of potential adverse NGO attention, etc.

A CSR Audit should cover the following points:

- ✓ **Human Rights:** Fundamental Human Rights, Freedom of association and Collective bargaining, Nondiscrimination, Forced labor, Child labor
- ✓ **Business behavior:** Relations with clients, suppliers and sub-contractors, Prevention of corruption and anticompetitive practices
- ✓ **Human Resources:** Labor relations, Working conditions including steps taken for preventing accidents and health hazards, health and safety measures including compensation in case of any accidents, career development and training, Remuneration system that motivates the employees.
- ✓ **Corporate Governance:** Board of Directors, Audit and internal controls, Treatment of shareholders, Executive remuneration
- ✓ **Environment:** Incorporation of environmental considerations into the manufacturing and distribution of products, and into their use and disposal, effect on pollution, pollution control measures undertaken,

- ✓ **Community Involvement:** Impacts on local communities, contribution to social and economic development, General interest causes, creation of socials infrastructure like roads, schools, hospitals.

9.

a) As a Management Auditor of a large organization, you have been asked to carry out the review of MARKETING POLICIES: as a part of Corporate Development. Prepare a questionnaire for carrying out such a review.

b) State the essential qualities required of a Management Auditor.

Answer:

9. (a) A questionnaire for review of 'Marketing Policies' of the company:

1) Consumer needs assessment –
   - ✓ Is the policy rationable in terms of marching customers' needs with the firm's offering and capabilities?
   - ✓ What is the likely consumer reaction?
   - ✓ What are the evaluation studies undertaken to assess consumer reaction, particularly, in respect of product features, price, distribution outlets, new product concept, new product introduction?

2) Market segmentation –
   - ✓ What is target market conceived?
   - ✓ Is market segmentation based on empirical data, such as-usage, demographic, benefits sought, consume characteristics etc.?

3) Competition and product position -
   - ✓ How many are competitive producers?
   - ✓ What is company's share in the total market?
   - ✓ How many competitors have left the market over the last few years?
   - ✓ What is the general competitive environment?
   - ✓ What particular product characteristics does the firm possess that contribute to the market place?
   - ✓ What is the relative market position of the products at different stages of their life cycle?

4) Marketing Mix-
   - ✓ How is the optimum mix of pricing, distribution and promotional policy for each of the products of firms determined?
   - ✓ What are the company's approaches to issue like product Design, products Positioning, Price-range, advertising and promotion media etc.?

5) Marketing programme
   - ✓ Is the marketing program of the company designed to emphasize lower price, mass distribution channels and mass advertising to reach numerous market segments?

6) Resource Allocation
   - ✓ Does the marketing program take into account the interdependencies among the various options and a resource allocation procedure to direct the company's commitment of resources among products, markets segments and the related marketing strategies to accomplish the objectives?
   - ✓ If so, how is the resource allocation procedure has been established for different marketing decisions?

(b) The Essential Qualities of A Management Auditor are:

(i) Ability to grasp business problems.

(ii) Ability to determine or assist the progress of the organization.

(iii) Knowledge of the principles of delegation of authority and control and the preparation of different budgets.

(iv) Power of grasping and understanding different internal control devices.

(v) General understanding of different laws.

(vi) Sufficient knowledge and experience in preparing various reports for submission to different levels of management including the top management.

(vii) Tactfulness, perseverance, pleasing and dynamic personality.

10.

a) What do you understand by environment audit and productivity audit?

b) "Management Audit team should be multidimensional."---Discuss.

c) Write short not on "Customer Costing in Service Sector"

d) What are the Management Audit Questionnaires?

e) "The Cost Audit Reports can be termed as propriety audit" ------Discuss.

Answer:

10. **(a)** Environment Audit is a systematic, documented, periodic and objective review by related entities, of facility operations and practice related to meeting environment requirements.

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

(b) As a management auditor is concerned with all aspects of business and the organization, ranging from manufacture to marketing and finance, the management audit team should be multidisciplinary to make multi dimensional approach to audit function.

(c) For customer costing purpose, the cost are divided into following categories. These are:

- Customer specific costs-Like the cost of express conveyer to a client/customer who requests over sight delivery of some important document.
- Customer line categories- These are the costs which are broken into the broad categories of customers and not individual customer.
- 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) A management audit questionnaire is an important tool for conducting the management audit. It is through these questionnaires that the auditors make an inquiry into important facts by measuring current performance. Such questionnaires aim at a comprehensive and constructive examination of an organization's management and its assigned tasks.

(e) The Cost Audit Reports can be termed as propriety audit as these reports seeks to ensure that actual expenditure at each stage is appropriate and optimum returns have been achieved. The cost auditor always aims at ensuring that the actual expenditure should not be prima facie more than what the occasion demands. The cost auditor has to report on matters which appear to him to be clearly wrong in principle, cases where the company's funds have been used in a negligent or inefficient manner, arm's length pricing of related party transactions, etc. These are the areas where the propriety aspect is involved and therefore cost audit may be in the nature of "propriety audit".

11.

a) You have been appointed as a Management Auditor by SBI Bank. The Bank has recently launched a scheme of 'Gold Card' issuing credit card to all savings account holders with average of ₹ 50,000/- in the account. How will you evaluate the internal control system in the area of credit card operations of the bank?

b) Discuss the risks that can be covered by a CSR Audit programme. Described the area covered by Corporate Services Audit.

Answer:

11. (a) The evaluation of internal control system in the area of credit operations in the bank would have to be done in respect of following aspects:

1) **Segregation of Responsibilities:** The activities relating to credit card operations can be divided in specific areas, namely, beginning from the receipt of application form, evaluating the credit assessment, sanctioning the issuance of card, making and dispatch of card would form part one of operations. Later on, particularly, from the accounting view, the significant operations would include receipt of statement from vendors/merchants, raising bills to customers, realization either by directly debiting the customers' accounts or payment received through cheques, periodic reconciliation, etc. While evaluating internal controls, it would have to be seen that adequate division of responsibilities have been carried out to avoid any collusion and independent checks have been built in the system. While evaluating the internal control, it may also be considered whether some part of the operations have been outsourced or performed in-house.

2) **Credit Assessment System:** Each application is scrutinized with reference to different parameters for assessing the credit limits to be awarded. The system must be able to generate exception reports at this stage itself. In fact, at the application stage itself, the system must ensure that the applicant was holding one card earlier or has defaulted in respect of any other agency.

3) **Control Over Issuance of Cards:** The internal control system must ensure that the cards are under the control of responsible official. Detailed records along with relevant pin codes, etc. have been kept. See that the system has built-in features that it is almost impossible to make counterfeit cards as also photographs are affixed to prohibit any unauthorized use of the same.

4) **Reconciling Merchant Records:** It is to be checked whether the system has built-in flexibility of reporting of the payments to be made to merchants and making prompt payment to them. Simultaneously, it should be seen that customer statements are also generated automatically and dispatched to them.

5) **Periodic Reconciliation and follow-up:** It may be seen whether periodic reconciliation of customers' accounts is done and regular follow-up of overdue accounts takes place. The person who are responsible for maintaining customers' records are not entrusted with the responsibility of reconciliation and follow-up.

(b) A CSR audit program can cover all or any of the following risks: -

- ✓ Effectiveness of the operating framework for CSR implementation
- ✓ Effectiveness of implementation of specific, large CSR projects
- ✓ Adequacy of internal control and review mechanisms
- ✓ Reliability of measures of performance
- ✓ Management of risks associated with external factors like regulatory compliance, management of potential adverse NGO attention, etc.

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

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

- ✓ **Consumers:** Quality of goods in right quantity at right price, right place and right time.
- ✓ **Employees:** Pay, Safety, Welfare and Industrial Relations etc.
- ✓ **Shareholders:** Safety of investment, satisfactory return and capital appreciation.
- ✓ **Community:** Social cost and social benefit, public relation
- ✓ **Fellow-businessmen:** Business ethics and fair trade dealings.
- ✓ **State:** Compliance with various legislations, fair trade practices, payment of taxes etc.

Study Note – 11

INTERNAL CONTROL, INTERNAL AUDIT AND OPERATIONAL AUDIT

Learning Objective: *Internal control, as defined in accounting and auditing, is a process for assuring of an organization's objectives in operational effectiveness and efficiency, reliable financial reporting, and compliance with laws, regulations and policies. Operational audit is a future-oriented, systematic, and independent evaluation of organizational activities. In Operational audit financial data may be used, but the primary sources of evidence are the operational policies and achievements related to organizational objectives. Operational audit is a more comprehensive form of an internal audit. This chapter discusses all those topics mentioned above.*

1. Choose the correct option among four alternative answer and justify your answer:

i) One of the major components of government audit is/are

a. Government Revenue
b. Union Budget and Control
c. Government Expenditure
d. Taxation and Fiscal Policies

ii) There is no requirement of Audit Working Papers while conducting audit and they only result in loss of time.

a. The Statement is Correct
b. The Statement is Incorrect
c. The Statement is Incomplete
d. None

iii) 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.

iv) Qualities of good Internal Auditor are/is

a. Right Attitude
b. Technical Expertise
c. Communication and other soft skills.
d. All of the above.

v) NGO(s) are incorporated under
   a. Societies Registration Act, 1860
   b. India Trust Act, 1882
   c. As Section 8 Company
   d. All of the above.

vi) Who can be appointed as Internal Auditor as per the Companies Act, 2013
   a. A Chartered Accountant
   b. A Cost Accountant
   c. Such other professional
   d. All of the above

vii) The management auditor shall consider in the evaluation of capacity utilization –
   a. Method of measuring base machine capacity
   b. Capacity measurement is based on "capital output ratio" or sundry other factors.
   c. Technical terminology like licensed capacity, installed capacity, rated capacity etc. should be properly defined.
   d. All of the above.

viii) An audit of or for a government agency is composed
   a. Financial compliance
   b. Economy and efficiency
   c. Program results.
   d. All of the above.

ix) Internal Audit is ____________________
   a. One time activity
   b. A continuous activity
   c. Half yearly
   d. None of above

x) Which section of Companies Act deals with Internal Audit
   a. Section 138
   b. Section 148
   c. Section 139
   d. Section 192

xi) Internal control system can be comprised of
a. Preventive Control
b. Detective Control
c. Corrective Control
d. All of the above

xii) Internal Audit can be performed by
a. Employee of the Organization
b. External Agencies
c. Management itself
d. Both a. and b.

xiii) C&AG has right to direct the manner in which the company's accounts shall be audited by the auditor and to give such auditor instructions in regard to any matter relating to the performance of his functions as per section_______________
a. 44AB of income Tax
b. 143 of the Companies Act, 2013
c. 173 of the Companies Act, 2013
d. 134 of the Companies Act, 2013

xiv) Non-Governmental Organizations can be incorporated as a company
a. Section 25 of the Companies Act, 1956.
b. Section 8 of the Companies Act, 2013.
c. Section 28 of the Companies Act, 2013.
d. None of the above

xv) Under 'propriety audit', the auditors try to bring out what type of expenditure:
a. Improper
b. Avoidable
c. In fructuous
d. All of the above

xvi) What is the first step to conduct Hospital Audit?
a. Check the letter of appointment
b. Study Trust Deed
c. Examine Records
d. Physical Verification

xvii) Co-operative Auditor has to conduct an examination of the overdue debts, if any, and a valuation of the assets and liabilities of the society while conducting 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

xviii) ------------------------ States about the audit of accounts of Municipalities.

a. Article 243Z of the Constitution
b. Article 243J of the Constitution
c. Both a. and b.
d. None of the above

xix) Who appoint the auditor for Government Company?

a. Board of Directors
b. Audit Committee.
c. C&AG
d. CBDT

xx) The government also engages in commercial activities and for the purpose it may incorporate _________ type of entities.

a. Five
b. Three
c. Many
d. Various.

xxi) Financial Administration of Local Bodies includes

a. Budgetary Procedure
b. Expenditure Control
c. Accounting System
d. All of the above

xxii) Field Balance Sheet Approach to audit can be applied in case of audit of the

a. Co-Operative societies
b. Local Body Corporate
c. Self-Help Group
d. Club

Answer:

1. **(i) Government Expenditure**

Audit of Government Expenditure is one of the major components of government audit conducted by the office of C & AG.

(ii) The Statement is Incorrect.

Audit working papers are the record of the planning and execution of the audit engagement. Auditors retain a set of working papers for each audit engagement for each year.

(iii) All of the above.

The following aspects may be taken into consideration for proper inventory control –

1. Maximum, minimum and reorder level fixation
2. VED analysis
3. Just-in time (JIT) purchasing
4. Fast moving, slow moving and non-moving analysis.

(iv) All of the above.

According to 'Technical Guide on Internal Auditing' by The Institute of Cost Accountants of India, Internal Auditor should have following three traits:

- Technical Expertise
- Right Attitude
- Communication and other soft skills.

An Internal Audit team has to have representation from diverse professional fields in order to understand the organization better.

(v) All of the above.

Non-Governmental Organizations (NGO) are generally incorporated as societies under the Societies Registration, Act, 1860 or as a trust under the India Trust Act, 1882, or under any other law corresponding to these Acts enforced in any part of India. NGO's can also be incorporated as a company under section 8 of the Companies Act, 2013.

(vi) All of the above.

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.

(vii) All of the above.

Yes, the management auditor shall consider the following points in the evaluation and measurement of capacity utilization.

(viii) All of the above.

An audit of or for a government agency is composed of three elements are as under

1. Financial compliance,
2. Economy and efficiency, and
3. Program results.

The typical definition of a financial audit would not include elements 2 and 3. These are operational auditing techniques.

(ix) A continuous activity.

Internal Audit is a continuous and systematic process of examining and reporting the operations and records of a concern.

(x) Section 138 of the Companies Act 2013

Section 138 of the Companies Act 2013 deals with provisions of Internal Audit.

(xi) All of the above.

Internal control system can be classified in three types Preventive Control, Detective Control and Corrective Control

(xii) Both a. and b.

Internal audit is a management tool performed by employees of the organization or external agencies specially assigned for this purpose.

(xiii) Section 143 of the Companies Act, 2013

The C&AG have powers under section 143 of the Companies Act, 2013 as follows:

To direct the manner in which the company's accounts shall be audited by the auditor and to give such auditor instructions in regard to any matter relating to the performance of his functions as such;

(xiv) Section 8 of the Companies Act, 2013.

Non-Governmental Organisations are generally incorporated as societies under the Societies Registration, Act, 1860 or as a trust under the India Trust Act, 1882, or under any other law corresponding to these Acts enforced in any part of India. NGO's can also be incorporated as a company under section 8 of the Companies Act, 2013.

(xv) All of the above.

Under 'propriety audit', the auditors try to bring out cases of improper, avoidable, or in fructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations

(xvi) Check the letter of appointment.

Check the letter of appointment to ascertain the scope of responsibilities.

(xvii) Section 17 (2) of the Co-operative Societies Act, 1912

Section 17 (2) of the Co-operative Societies Act, 1912 specifically requires the auditor to conduct an examination of the overdue debts, if any, and a valuation of the assets and liabilities of the society.

(xviii) Article 243Z of the Constitution.

Article 243J of the Constitution states that the Legislature of a State may, by law, make provisions with respect to the maintenance of accounts by the Panchayats and the auditing of such accounts.

Article 243Z of the Constitution states about the audit of accounts of Municipalities. The Legislature of a State may, by law, make provisions with respect to the maintenance of accounts by the Municipalities and the auditing of such accounts.

(xix) C&AG.

The auditor of a government company is appointed by the C&AG.

(xx) Three.

The government also engages in commercial activities and for the purpose it may incorporate following types of entities:

a. Departmental enterprises engaged in commercial and trading operations.
b. Statutory corporations created by specific statues such as LIC, Air India, etc.
c. Government companies, set up under the Companies Act, 2013.

(xxi) **All of the above.**

Financial Administration of Local Bodies has three components Budgetary Procedure, Expenditure Control and Accounting System.

(xxii) **Self-Help Group.**

Field Balance Sheet Approach to audit can be applied in case of audit of the Self-Help Group. The auditor prepares the Field Balance Sheet for the group, as on the date of the audit, based on the SHG's internal records and then cross checks the correctness of balance sheet items. The primary objective is to ascertain the retained earnings of the SHG.

2.

a) **ITC Ltd. organized a three-day International Conference of Accountants in Mumbai. You are asked to conduct internal audit the accounts of the conference. Draft the internal audit programme for audit of receipt of participation fees from delegates to the conference.**

b) **You have been appointed as an internal auditor for M/s ELECTROCON Ltd which is a large manufacturing concern. You are asked to verify whether there are adequate records for identification and value of Plant and Machinery, tools and dies and whether any of these items have become obsolescent and not in use.**

Draft a suitable audit programme for the above.

Answer:

2. **(a)** Audit of Receipts of Participation Fees The organization of three-day International Conference of Accountants in Bangalore by ITC LTD. is a one-time event. Normally, in view of mega-size of the event, a special cell is made in the organization to handle the entire event. Since few people would be handling the event, the internal controls may not be that strong and, thus, more emphasis is required to be given on substantive procedure. Audit of receipt of participation fees should be under the following areas:

Internal Control System

- ✓ Examine the organization structure of special cell created for the International Conference, if any, and division of responsibilities amongst persons and control/custody over receipt books.
- ✓ Verify the internal control system for restricting the participation of unregistered delegates.

Rate of Participation Fees

- ✓ Verify with reference to resolution passed by the Organizing Committee of ITC LTD.
- ✓ Also verify the rate from the literature/registration form circulated for promotion of conference.

Receipts of Participation Fees

- ✓ Verify counter foil of the receipts issued for individual registration.
- ✓ Ensure that receipts are issued for all the registration received in cash.
- ✓ Trace the receipts in Bank Statement or Cash Book – as the case may be.
- ✓ Verify Bank Reconciliation Statement and list out dishonored cheques.
- ✓ Verify subsequent recovery in respect of dishonored cheques.

Overall Checking

Verify the total receipts of participation fees shown in the financial statements with reference to total number of receipts issued to participants.

Cross check the total number of delegates with reference to the following:

- ✓ Kits distributed to participants.
- ✓ Bill of caterer for providing meals during conference.
- ✓ Capacity of the Hall.
- ✓ Participation Certificate if any issued.

Foreign Delegates

In case of foreign delegates – if registration fees are higher – ensure that they are registered at higher fees.

Special Issues:

- ✓ Take out list of absentees and in case of nil absentees, probe the issue further.
- ✓ If certain participants are exempted from payment of fees – obtain the list along with proper authorization in this regard.

(b) The Internal Audit Programme in connection with Plant and Machinery and Tools and Dies may be on the following lines:

- ❖ Internal Control Aspects: The following may be incorporated in the audit programme to check the internal control aspects:
  - ✓ Maintaining separate register for hired assets, leased asset and jointly owned assets.

- ✓ Maintaining register of fixed asset and reconciling to physical inspection of fixed asset and to nominal ledger.
- ✓ All movements of assets are accurately recorded.
- ✓ Authorization be obtained for –
  - (i) a declaring a fixed asset scrapped.
  - (ii) selling a fixed asset.
- ✓ Check whether additions to fixed asset register are verified and checked by authorised person.
- ✓ Proper recording of all additions and disposal.
- ✓ Examining procedure for the purchase of new fixed assets, including written authority, work order, voucher and other relevant evidence.
- ✓ Regular review of adequate security arrangements.
- ✓ Periodic inspection of assets is done or not.

- ❖ Regular review of insurance cover requirements over fixed assets.
  - i) Assets Register: To review the registers and records of plant, machinery, etc. showing clearly the date of purchase of assets, cost price, location, depreciation charged, etc.
  - ii) Cost Report and Journal Register: To review the cost relating to each plant and machinery and to verify items which have been capitalised.
  - iii) Code Register: To see that each item of plant and machinery has been given a distinct code number to facilitate identification and verify the maintenance of Code Register.
  - iv) Physical Verification: To see physical verification has been conducted at frequent intervals.
  - v) Movement Register: To verify (a) whether a Movement Register for movable equipments and (b) log books in case of vehicles, etc. are being maintained properly.
  - vi) Assets Disposal Register: To review whether assets have been disposed off after proper technical and financial advice and sales/disposal/retirement, etc. of these assets are governed by authorisation, sales memos or other appropriate documents.
  - vii) Spare Parts Register: To examine the maintenance of a separate register of tools, spare parts for each plant and machinery.
  - viii) Review of Maintenance: To scrutinize the programme for an actual periodical servicing and overhauling of machines and to examine the extent of utilisation of maintenance department services.

ix) Review of Obsolescence: To scrutinize whether expert's opinion have been obtained from time to time to ensure purchase of technically most useful efficient and advanced machinery after a thorough study.

x) Review of R&D: To review R&D activity and ascertain the extent of its relevance to the operations of the organisation, maintenance of machinery efficiency and prevention of early obsolescence.

3.

a) What is Audit programme? What are the advantages of Audit Programme?

b) Draft Internal Control Questionnaire Relating to Inventory

Answer:

3. (a) An audit programme is a detailed plan of the auditing work to be performed, specifying the procedures to be followed in verification of each item and the financial statements and the estimated time required. To be more comprehensive, an audit programme is written plan containing exact details with regard to the conduct of a particular audit. It is a description or memorandum of the work to be done during an audit. Audit programme serves as a guide in arranging and distributing the audit work as well as checking against the possibility of the omissions.

Advantages:

The main advantages of an audit programme are as follows:

- ✓ It serves as a ready check list of audit procedures to be performed.
- ✓ The audit work can be properly allocated to the audit assistants or the article clerks.
- ✓ The auditor may easily know the extent of work done at any point of time. Thus, the progress of work done can be under the supervision and control of the auditor.
- ✓ Audit programme would not only be useful for the audit assistants in carrying the audit work but for the principal too as he would be in a position to account for the individual responsibilities.
- ✓ A uniformity of the work can be attained as the same programme would be followed from time to time. It is a useful basis for planning the programme for the following year.
- ✓ It may be used as evidence by the auditor in the event when any charge is brought against him. He can prove that there has no negligence on his part and he exercised reasonable care and skill while performing the task.

(b) Is the storage accommodation adequate to provide production against

- Deterioration?
- Access by unauthorized persons?
- Any other local hazards?

1. Are issues from stores made only on properly authorized requisition?
2. Who are authorized to sign requisition? Specify name, position etc.
3. Are bin cards or similar records maintained at stores location?
4. Are continuous stock records maintained for
   - raw materials?
   - bought out components?
   - consumable stores?
   - finished goods?
   - stocks held on behalf of third parties?
5. Are these records maintained
   - in quantity only?
   - In value only?
   - In both quantity and value?
6. Are stores record maintained by a person independent of
   - The stores keepers?
   - Those responsible for physically counting or checking stocks?
7. Are independently maintained control accounts kept for each category of stock set out in 5?
8. Is the counting system fully integrated with the financial records?
9. If not, are totals of various categories of costs (including overheads) regularly reconciled with the actual costs in the financial records?
10. Are works orders issued
    - against specific orders?
    - on the basis of predetermined production targets?
    - on some other basis. (describe)
11. How are works orders authorized? Specify:
12. On what basis are materials, labour and other direct costs charged to work-in-progress accounts? Specify.
13. Are overheads clearly divided into fixed and variable overheads?
14. What is the basis of allocation of overheads to costs and what overheads are recovered in this way? Specify:
15. Does the system ensure that excess or abortive costs are written off and not carried forward in work-in-progress?

4.

a) What do you understand by Propriety Audit in the Context of Government Audit?

b) Who shall constitute Audit Committee under The Companies Act 2013?

c) What are the points to be consider by Management Auditor while determining the adequacy of Budgetary Control System?

Answer:

4. (a) Under 'propriety audit', the auditors try 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.

(b) The Board of directors of every listed company and the following classes of companies, as prescribed under Rule 6 of Companies (Meetings of Board and its powers) Rules, 2014 shall constitute an Audit Committee:

- ✓ all public companies with a paid up capital of ₹10 Crores or more;
- ✓ all public companies having turnover of ₹100 Crores or more;
- ✓ all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding 50 Crores or more.

The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.

(c) The management auditor should examine and appraise the following points:-

(i) In the area of planning:

- ✓ Where it covers all interrelated functions like production, sales, purchasing and finance.
- ✓ Whether it determines the linkage between budget centres and responsibility centres.
- ✓ Whether it establishes definite goals and limits for these function well in advance. The system must answer the questions such as "what they are expected to operate?"

What will be the financial requirement for the functional areas? What would be the potential problems in the key areas?

(ii) In the area of coordination:

- ✓ Whether the budget monitoring committee holds its meeting regularly with a view to ensure performance evaluation.
- ✓ Whether it helps to prevent waste that results in duplicate or cross purpose activities.
- ✓ Whether it reveals timelines in the process of preparation and approval of all functional budgets and master budget.

(iii) In the area of control:

- ✓ Whether system exists for measuring, comparing and quantifying the results of all functional areas.
- ✓ Whether the budget incorporates a degree of flexibility with a provision of its periodical review.
- ✓ Whether the variance reports are issued in time and appropriate corrective action is taken on these variances.

5.

a) Discuss in brief regarding Summery Report to Top Management.

b) Draft Internal Audit Programme in respect of Wages.

Answer:

5. (a) It may be the policy of the management to have copies of the Internal Audit Report in which there might be important findings. In such cases, the copy that might be endorsed to the top management should contain a summary sheet giving gist of the audit report. It should be appreciated that top people are busy and have not much time to spare to go through the detailed report. The list should highlight the conclusion and the remedial suggestions to correct the deficient conditions. The management would then be able to get an idea of the audit findings easily with minimum loss of time. The necessary details might also be referred to from the detailed report.

Summary reports to management usually would have two distinct functions –

1) They would tell what the internal audit department has accomplished when compared to what was planned.
2) They would show conclusions of the auditors in a summarized form.

The significant ones may be advised to be corrected immediately, leaving the less important ones for taking action a bit later. Such report should be under distinct subheads like the following:-

- ✓ Major irregularities needing immediate attention.
- ✓ Routine irregularities of consequence.
- ✓ Case of supervisory lapses which may result in heavy loss etc.

In the first category irregularities like non-maintenance of stock account of receipt books, meeting departmental expenditure from cash collected in violation of the instructions in this regard may be included. In the second category may come non-posting of entries to make records like stock cards etc. up to date, non-reconciliation of control accounts with the subsidiary ledger etc. In the third category may be included absence of supervisory check in the cash books, bill register, absence of supervisory percentage checking of the suppliers/ contractors bill etc.

(b)

1. Checking of Master Roll, Pay Roll vis-à-vis Actuarial Valuation List prepared for the purpose of computation of Gratuity;
2. System of recording the attendance;
3. Scrutiny of attendance / absenteeism record – for Staff, Sub-staff & Workers;
4. Verification of final Deployment Book with the Field (i.e. rough) Deployment Book/ Record as well as Daily Attendance Record ;
5. Checking of procedure followed for disbursement of wages, bonus etc;
6. Checking of records for unpaid Wages & unpaid Bonus and their subsequent disbursement;
7. Checking of computation of Wages of Casual/ Contractual Workers with reference to basic records maintained for recording their attendance;
8. Checking of Payment Vouchers for disbursement of Wages to Casual/ Contractual workers;
9. Checking of basic records maintained for payment of incentives, i.e. for plucking, tapping, picking of Coffee Seeds with reference to minimum task fixed;
10. Procedure followed for recovery of Cost of electricity provided to Staff/ workers' quarters and records maintained there for;
11. Procedures followed for recovery of cost of food stuff issued to workers,
12. Payment of Sick Allowance, Maternity Benefits, Leave with Wages, Holiday Wages, Bonus including records maintained there for;
13. Checking of system of payment of Overtime;
14. Procedure for payment of Advance to Staff/ Workers and Management Staff and their recovery including records maintained there for;
15. Checking of computation of Leave with Wages and their disbursement.

6.

a) Describe the needs for capacity determining?

b) Factors to be considered by Cost Auditor while evaluating MIS?

c) Give a ―Audit programme as an Internal Auditor of Wage Audit.

Answer:

6. (a) The need for determining "production capacity" in respect of industrial organisation in India arises from the following reasons :-

- ✓ To meet the requirement under Section 129 of the Companies Act, 2016, that prescribes the form and contents of the balance sheet as well as profit and loss account (Schedule III of the Companies Act).
- ✓ For purpose of Cost Audit Report under section 148 of the Companies Act, 2013 where a cost audit has been ordered by Government.
- ✓ For internal management purpose, to be used:
- ✓ In planning, scheduling and controlling production, and
- ✓ In planning expansion of capacity and correction of imbalances.
- ✓ For assessment of capacities for national level planning.
- ✓ For fixing the price of product(s) after ascertaining the capacity costs and per unit incidence thereof etc.

(b) The cost auditor has to consider various aspects while evaluating the effectiveness of a Management Information System. At first he should consider the following aspects while appraising the MIS –

- ✓ the content, quality and source of information
- ✓ flow of information from the originator to the receiver, and
- ✓ Correlation of information in the decisional are as. Contents and sources of information: This may include the following
- ✓ Whether the information collected is relevant to the decision problem or whether it will result in the improvement in the quality of decisions.
- ✓ Whether there is any tendency of the manager to use control data for postmortem exercise
- ✓ Whether the reporting of MIS is regular and uniform for financial and non-financial information.
- ✓ Whether the information contain unwanted information.
- ✓ Whether the MIS adequately caters to the requirements of decision makers.

Flow of information: A cost auditor has to proceed on the following lines:

(i) System organization:
- ✓ System is centralized or decentralized,
- ✓ Flow of information from various units to the control section,
- ✓ Estimating the volume of data, transmission time and cost,
- ✓ Cost-benefit analysis of centralized v. decentralized information.

(ii) Data collection and management: Appraisal should include the following aspects:
- ✓ methodology of collecting data,
- ✓ whether the data is filtered and classified,
- ✓ whether the data is properly matched with decision problems,
- ✓ whether the management carried out detailed study regarding existing frequency,
- ✓ Whether system design is free or any possible constraints.

(iii) Correlation of MIS with the decision areas: Cost auditor should examine this aspect from the following angles:
- ✓ Whether input-output analysis is attempted.
- ✓ Whether MIS is helpful in reducing the effects of uncertainty.
- ✓ Whether MIS is cost-effective.
- ✓ Whether the information is being supplied to the users very effectively.
- ✓ Whether MIS is providing a feedback for corrective action, and
- ✓ Whether MIS is able to optimize the value of information?

(c) (I) Audit programme as an internal Auditor of Wage Audit:
- ✓ Information about Auditee and audit work:
- ✓ Name of the Auditee .
- ✓ Address/Location.
- ✓ Period to be covered.
- ✓ Estimated time(days) required.
- ✓ Audit Team members consists of Partner/Qualified/Semi-qualified etc.
- ✓ Queries of the Auditor to be settled by the representative of the concern.
- ✓ Report to be submitted to the representative of the company.

(II) Study of various records:
- ✓ Wage related policy manuals.
- ✓ Grade Structure.
- ✓ Incentive Rules.
- ✓ Overtime Rule.

- ✓ Bonus Scheme.
- ✓ Various Statutory deduction schemes as for example ESI, PF, EPF etc.

(III) Verification of:

- ✓ Payroll package is properly updated with employee's details and it is properly functioning.
- ✓ Take out the list of employees for the purpose of verification that no entry is bogus i.e., Ghost Worker.
- ✓ Ensure that all wage payments are made through banks.
- ✓ Where payment is made in cash, whether it is done in presence of responsible officer.
- ✓ Cross verify wage with some employees, so that there will be assurance with system.
- ✓ Checking of Daily Attendance Sheet, Absenteeism Statement, Manpower Planning and Deployment.
- ✓ Checking of Employee Signature at the time of payment in case of cash payment and Attendance Register.
- ✓ Checking of Appointment/Retirement records of Employees.

7.

a) As per Companies Act 2013 which companies are required to conduct Internal Audit?

b) Who can be appointed as internal auditor as per The Companies' Act 2013?

Answer:

7. (a) Section 138 of the Companies Act 2013 read with rule 13 - companies(accounts) rules, 2014 states that the following class of companies shall be required to appoint an internal auditor or a firm of internal auditors, namely:-

- ✓ Every listed company;
- ✓ Every unlisted public company having-
  - a. Paid up share wealth of fifty crore rupees or more during the preceding financial year; or
  - b. Turnover of two hundred crore rupees or more during the preceding financial year; or
  - c. Outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
  - d. Outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and

- ✓ Every private company having-
  a. Turnover of two hundred crore rupees or more during the preceding financial year; or
  b. Outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year:

  Provided that an existing company covered under any of the above criteria shall comply with the requirements of section 138 and this rule within six months of commencement of such section.

(b) Section 138 of the companies act 2013 deals with provisions of internal audit. As per section 138, (1) Such class or classes of companies as may be prescribed shall be required to appoint an internal auditor, who 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.

So, a chartered accountant or a cost accountant or a such other professional can be appointed as internal auditor of a company as decided by Board to conduct internal audit.

8.

a) Management Audit and Operational Audit are complementary and supplementary to one another". Discuss in brief.

b) What is the Role of Management with regard to Internal Control

Answer:

8. (a) Management Audit is wider in scope compared to Operational Audit.

Management Audit is concerned with quality of managing whereas Operational Audit centres on the quality of operation. Operational Audit is an audit for the management and Management Audit is an audit of the management also.

The basic difference between the two audits is not in method, but in the level of appraisal. In management audit, the auditor is to make his tests to the level of top management, its formulation of objectives, plans and policies and its decision making. It is not that he just verifies the operations of control and procedures and fulfillment of plans in conformity with the prescribed policies.

The auditor is to reach the root i.e., the functions of top management which lay down objectives and policies, provide means and procedures of implementation and control and which actually engage in direction and control on a continuous basis. In addition to what would normally be covered in an operational audit, management audit would also encompass the relevance and effectiveness of the aims, duties and decisions of management at various levels, plans, policies and decisions of the top management. Every aspect of the functions of Board of Directors should be in conformity with the objects set out in the constituting document. Similarly, the managing director, if any, should act not only in accordance with the mandate he has received but he should ensure that the decisions he takes are in conformity with the objects of the company and the policies formulated by the Board. The effectiveness of management under the control of managing director and the various members of the Board including those in charge of finance, production, sales etc., should be subject to review of the management auditor.

Therefore, it can be said that the two audits are complementary and supplementary to one another.

(b) The responsibility of Management with regard to internal Control can be summarized as under-

- ❖ 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.
- ❖ Review of system: The system installed, should be reviewed by the Management to ascertain, whether-
    - ✓ The prescribed Management policies are being properly interpreted by the employees and are faithfully implemented,
    - ✓ The prescribed procedures need a revision due to changed circumstances or whether they have become obsolete or cumbersome, and
    - ✓ Effective corrective measures are taken promptly when the system appears to breakdown
- ❖ 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.

9.

a) State four objectives of Operational Audit.

b) Write a note on "Audit Committee" under the Companies Act, 2013 in brief.

Answer:

9. (a) Generally, operational audit objectives include:

1) Appraisal of controls: The most significant gain an organisation can derive from operational auditing is probably in the area of appraisal of controls.
2) Evaluation of performance: In performance appraisal, the operational auditor is basically concerned not so much with how well technically the operations are going on, but with accumulating information and evidence to measure the effectiveness, efficiency and economy with which the operations are being carried on.
3) Appraisal of objectives and plans: . Operational auditor may look into the aspects like whether objectives are clearly spelt out and properly communicated to the personnel responsible for implementation and whether the personnel have understood the objectives in the sense meant by the management. Also, he can take note of any apparent conflict in the objectives for its effect on operations.
4) Appraisal of organisational structure: Organisational structure provides the line of relationships and delegation of authority and tasks. Therefore, this is also another important area for appraisal by the operational auditor.

(b) Under section 177 of the Companies Act, 2013,

1) The Board of Directors of every listed company and such other class or classes of companies, as may be prescribed, shall constitute an Audit Committee.
2) The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority.
   Provided that majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand, the financial statement.
3) Every Audit Committee of a company existing immediately before the commencement of this act shall, within one year of such commencement, be reconstituted in accordance with subsection (2).
4) Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall inter alia, include,—
   - ✓ The recommendation for appointment, remuneration and terms of appointment of auditors of the company;

- ✓ Review and monitor the auditor's independence and performance, and effectiveness of audit process;
- ✓ Examination of the financial statement and the auditors' report thereon;
- ✓ Approval or any subsequent modification of transactions of the company with related parties;
- ✓ Scrutiny of inter-corporate loans and investments;
- ✓ Valuation of Undertakings Or Assets of the Company, wherever it is necessary;
- ✓ Evaluation of internal financial controls and risk management systems;
- ✓ Monitoring the end use of funds raised through public offers and related matters.

5) The Audit Committee may call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.
6) The audit committee shall have authority to investigate into any matter in relation to the items specified in sub-section (4) or referred to it by the Board and for this purpose shall have power to obtain professional advice from external sources and have full access to information contained in the records of the company.
7) The auditors of a company and the key managerial personnel shall have a right to be heard in the meetings of the Audit Committee when it considers the Auditor's Report but shall not have the right to vote.
8) The Board's report under sub-section (3) of section 134 shall disclose the composition of an Audit Committee and where the Board had not accepted any recommendation of the Audit Committee, the same shall be disclosed in such report along with the reasons therefore.
9) Every listed company or such class or classes of companies, as may be prescribed, shall establish a vigil mechanism for directors and employees to report genuine concerns in such manner as may be prescribed.
10) The vigil mechanism under sub-section (9) shall provide for adequate safeguards against victimization of persons who use such mechanism and make provision for direct access to the Chairperson of the Audit Committee in appropriate or exceptional cases.

Provided that the details of establishment of such mechanism shall be disclosed by the company on its website, if any, and in the Board's report.

10.

a) Which companies are required to constitute Audit Committees? What Is its responsibility regarding internal audit.

b) What are the qualities of a good internal auditor?

c) KPC Pvt. Ltd took a consortium loan in 2017-18 amounting to ₹80 crores of which State Bank of India is the leading Bank for setting up a new plant in Haldia. During the year 2016-17 its outstanding loan was ₹70 crores of which repayment was made in the year 2017-18 to the extent of ₹20 crores. Should KPC Pvt. Ltd. conduct internal audit as per Companies Act 2013?

Answer:

10. (a) The Board of directors of every listed company and the following classes of companies, as prescribed under Rule 6 of Companies (Meetings of Board and its powers) Rules, 2014 shall constitute an Audit Committee:

- ✓ All public companies with a paid up capital of ₹10 Crores or more;
- ✓ All public companies having turnover of ₹100 Crores or more;
- ✓ All public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding ₹50 Crores or more.

The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this Rule.

Responsibility of audit committee is to review adequacy of internal audit function and internal audit reports.

(b) According to 'Technical Guide on Internal Auditing' by The Institute of Cost Accountants of India, Internal Auditor should have following three traits:

- ✓ Technical Expertise
- ✓ Right Attitude
- ✓ Communication and other soft skills.

An Internal Audit team has to have representation from diverse professional fields in order to understand the organization better, audit its function better and making internal audit recommendation better. Carrying 'right attitude' is most sought after skill of Internal auditor. Communication skills of Internal Auditor should be so strong to fit him in different roles while providing suggestion and consultancy to the Audit Committee, top Management and Auditees. Other soft skills include optimistic mindset, emotion regulation and presentation skills.

(c) Section 138 of the companies act 2013 deals with provisions of internal audit. Section 138 of the Companies Act 2013 read with Rule 13 - Companies(Accounts) Rules, 2014 states that the following class of companies shall be required to appoint an internal auditor or a firm of internal auditors, every private company having-

- ✓ Turnover of two hundred crore rupees or more during the preceding financial year; or
- ✓ Outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year:

Provided that an existing company covered under any of the above criteria shall comply with the requirements of section 138 and this rule within six months of commencement of such section.

Outstanding loan of KPC Pvt. Ltd. is ₹130 crores as on 31st March 2018. So the Company is required to appoint internal auditor as per Companies Act 2013 read with Rule 13 of Companies (Accounts) Rules, 2014.

11.

a) Discuss Audit Procedure for Conducting the Audit of Non-Governmental Organisation NGO's.

b) Discuss the Role of C&AG in the Audit of a Government company.

Answer:

11. (a) Audit Procedure for Conducting the Audit of Non-Governmental Organisation NGO's can be defined as nonprofit making organisations which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives. Non-Governmental Organisations are generally incorporated as societies under the Societies Registration, Act, 1860 or as a trust under the India Trust Act, 1882, or under any other law corresponding to these Acts enforced in any part of India. NGO's can also be incorporated as a company under section 8 of the Companies Act, 2013. While planning the audit of a Non-Governmental Organisation (NGO), the auditor may concentrate on the following;

i) Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operates.
ii) Reviewing the legal form of the organisation and its Memorandum of Association, Articles of Association, rules and Regulations.
iii) Reviewing the NGO's Organisation chart, Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and Formats, budgetary policies, if any.
iv) Examination of minutes of the Board/Managing Committee/Governing Body/Management and Committees thereof to ascertain the impact of any decisions on the financial records.
v) Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.

The audit programme should include in a sequential order all assets, liabilities, income and expenditure ensuring that no material is omitted:

(I) **Corpus fund:** The contributions/grants received towards corpus be vouched with reference to the letters from the donor(s). The interest income be checked with investment Register and physical investments in hand.
(II) **Reserves:** Vouch transfers from projects / programmes with donors letters and board resolutions of NGO. Also check transfers and adjustments made during the year.
(III) **Ear-marked Funds:** Check requirements of donors' institutions, board resolution of NGO, rules and regulations of the schemes of the ear-marked funds.
(IV) **Project/Agency Balances:** Vouch disbursements and expenditures as per agreements with donors for each of the balances.
(V) **Loans:** Vouch loans with loan agreements receipt counter –foil issued.
(VI) **Fixed Assets:** Vouch all acquisitions/sale or disposal of assets including depreciation and the authorizations for the same. Also check donor's letters/agreements for the grants. For immovable property, check title, etc.
(VII) **Investments:** Check Investment Register and the investments physically ensuring that investments are in the name of the NGO. Verify further investments and dis-investments for approval by the appropriate authority and reference in the bank accounts for the principal amount and interest.
(VIII) **Cash in Hand:** Physically verify the cash in hand and imprest balance, at the close of the year and whether it tallies with the books of accounts.
(IX) **Bank Balance:** Check the bank reconciliation statements and ascertain details for old outstanding and unadjusted amounts.

(X) **Stock in Hand:** Verify stock in hand and obtain certificate from the management for the quantities and valuation of the same.

(XI) **Programme and Project Expenses:** Verify agreement with donor/contributor (s) supporting the particular programme or project to ascertain the conditions with respect to undertaking the programme/project and accordingly, in the case of programmes /projects involving contracts, ensure that income tax is deducted, deposited and returns filed and verify the terms of the contract.

(XII) **Establishment Expenses:** Verify that provident fund, life insurance and their administrative charges are deducted, contributed and deposited within the prescribed time. Also check other office and administrative expenses such as postage, stationery, travelling, etc.

The receipt of income of NGO may be checked on the following lines:

i) **Contribution and Grants for projects and programmes:** Check agreements with donors and grants letters to ensure that funds received have been accounted for. Check that all foreign contribution receipts are deposited in the foreign contribution bank account as notified under the Foreign Contribution (Regulation)Act, 1976.

ii) **Receipts from Fund arising programmes:** Verify in detail the internal control system and ascertain who are the persons responsible for collection of funds and mode of receipt. Ensure that collections are counted and deposited in the bank daily.

iii) **Membership Fees:** Check fees received with membership register, ensure proper classification is made between entrance and annual fees and life membership fees. Reconcile fees received with fees to be received during the year.

iv) **Subscription:** Check with subscription register and receipts issued. Reconcile subscription received with printing and despatch of corresponding magazine/ circulars/periodicals. Check the receipts with subscription rate schedule.

v) **Interest and Dividends:** Check the interest and dividends received and receivable with investments held during the year.

(b) The auditor of a government company is appointed by the C&AG.

The C&AG have powers under section 143 of the Companies Act, 2013 as follows:

✓ To direct the manner in which the company's accounts shall be audited by the auditor and to give such auditor instructions in regard to any matter relating to the performance of his functions as such;

✓ To conduct a supplementary or test audit of the company's accounts by such person or persons as he may authorise in this behalf; and for the purposes of such audit, to require information or additional information to be furnished to person or persons so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General may, by general or special order; direct.

In addition, the C&AG has a right to comment upon or supplement the audit report in such manner as he thinks fit.

12.

a) Define Local Bodies and state the financial administrative features of local bodies.

b) What is the basic objective of local body? And discuss the audit programme of the same.

Answer:

12. (a) Local bodies are institutions of the local self governance, which look after the administration of an area or small community such as villages, towns, or cities. 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).

Article 243J of the Constitution states that the Legislature of a State may, by law, make provisions with respect to the maintenance of accounts by the Panchayats and the auditing of such accounts.

Article 243Z of the Constitution states about the audit of accounts of Municipalities. The Legislature of a State may, by law, make provisions with respect to the maintenance of accounts by the Municipalities and the auditing of such accounts.

Salient Features of Financial Administration of Local Bodies

i) **Budgetary Procedure:** The objective of local bodies budgetary procedure are financial accountability, control of expenditure, and to ensure that funds are raised and moneys are spent by the executive departments in accordance with the rules and regulations and within the limits of sanction and authorization by the legislature or Council. Different aspects covered in budgeting are determining the level of taxation, fees, rates, and laying down the ceiling on expenditure, under revenue and capital heads.

ii) **Expenditure Control:** At the State and Central level, there is a clear demarcation between the legislature and executive. In the local body, legislative powers are vested in the Council whereas executive powers are delegated to the officers, e.g., Commissioners. All matters of regular revenue and expenditures are generally delegated to the executive wing. For special situations like, reduction in property taxes, refund of security deposits, etc., sanction from the legislative wing is necessary.

iii) **Accounting System:** Municipal Accounting System has been conventionally prepared under the cash system. In the recent past however, it is being changed to the accrual system of accounting. The accounting system is characterised by
- Subsidiary and statistical registers for taxes, assets, cheques etc.,
- Separate vouchers for each type of transaction,
- Compulsory monthly bank reconciliation,
- Submission of summary reports on periodical basis to different authorities at regional and state level.

(b) The objective of audit of Local Bodies is as under:
- ✓ To report the content and presentation of financial statements are true and fair
- ✓ Detection and prevention of error fraud, misuse of funds
- ✓ To ascertain that full value received for money spent
- ✓ Legal and administrative requirements fulfilled

The audit programme for local bodies include the following:
- ✓ All sanctions are accorded by competent authority
- ✓ Expenditure incurred are according to provisions and as per regulations framed by competent authority

Different schemes, programmes, and projects are running economically and the purpose such programme is achieved.

13.

a) What is the first step in audit of the education institutions?

b) How do you classify Local Bodies?

c) What point should be checked by internal auditor while performing internal audit of hotels with respect to internal control system?

Answer:

13. **(a)** 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.

(b) 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).

(c) Pilferage is one of the greatest problems in any hotel and it is extremely important to have a proper internal control to minimize the leakage. The following points should be checked:

- Effectiveness of arrangement regarding receipts and disbursements of cash.
- Procedure for purchase and stocking of various commodities and provisions.
- Procedure regarding billing of the customers in respect of room service, telephone, laundry, etc.
- System regarding recording and physical custody of edibles, wines, cigarettes, crockery and cutlery, linen, furniture, carpets, etc.
- Ensure that are trading accounts are prepared preferably weekly, for each sales point. A scrutiny of the percentage of profit should be made, and any deviation from the norms is to be investigated.

14.

(a) **Point to be considered while performing audit of Hospital?**

(b) **What points should be considered in audit programme of Local Bodies**

(c) **Discus the responsibility of Management with regard to internal Control**

Answer:

14. **(a)** The following points are to be considered necessary for conducting an audit of Hospital.

- Check the letter of appointment to ascertain the scope of responsibilities.
- Study the Charter or Trust Deed under which the hospital has been set up and take a special note of the provisions affecting the accounts.

- Examine, evaluate and verify the system of internal check, internal control and determine the nature, timing and the extent of the audit procedures.
- Vouch the entries in the Patient's Bill Register with a copies of bill issued. Test check the selected bills to see that these have been correctly prepared taking into consideration the period of stay of each patient as recorded in the Attendance Schedule.
- Vouch the collection from patients with copies of bills and entries in Bills Register. Arrears of dues should be properly carried forward and where these are deemed to be irrecoverable, they should be written off under due authorizations.
- Interest and/ or dividend income should be vouched with reference to the Investment Register and Interest and Dividend warrants.
- In case of legacies and donations which are received for specific purposes, it should be ensured that any income there from is not utilized for any other purposes.
- Where receipts of subscription show a significant deviations from budgeted figures, it should be thoroughly
- Inquired into and the matter be brought to the notice of the trustees or the Managing Committee.
- Government grants or grants from local bodies should be verified with the reference to the correspondence with the concerned authorities.
- Clear distinction should be made between the items of capital and revenue nature.
- The capital expenditure should be incurred under proper authorization by a valid resolution of the trustee for the Managing Committee.
- Verify the system of internal check as regards purchases and issue of stores, medicines etc.
- Examine that the appointment of the staff, payment of salaries etc. are duly authorized.
- Physically verify the investments, fixed assets and inventories.
- Check that adequate depreciation has been provided on all the depreciable assets.

(b) The audit programme for local bodies include the following:

- All sanctions are accorded by competent authority
- Expenditure incurred are according to provisions and as per regulations framed by competent authority
- Different schemes, programmes, and projects are running economically and the purpose such programme is achieved.

(c) The responsibility 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-

- The prescribed Management policies are being properly interpreted by the employees and are faithfully implemented,
- The prescribed procedures need a revision due to changed circumstances or whether they have become obsolete or cumbersome, and
- Effective 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.

15.

a) Write a short note on Self-Help Group.

b) Discuss the special feature of Co-operative Society Audit.

Answer:

15. (a) Self Help Group (SHG) Movement in India has been recognized as an effective strategy for mobilization and empowerment of rural people, particularly poor women and other marginalized groups .In India, Self Help Groups or SHGs represent a unique approach to financial intermediation. The approach combines access to low-cost financial services involving a process of self-management, with an objective of social and economic development for the women SHG members. Formations of SHGs are facilitated by the Government or by NGOs. SHGs are linked not only to banks but also to wider development programmes, SHGs are seen to confer many benefits, both economic and social.

As expert accounting professionals are hardly available at Gram Panchayat level, the need of the hour is "Community Audit" and it is necessary to develop sufficient number of "Community Auditors" for the sake of financial transparency.

The Institute & WBSRLM have entered into a MOU to enable undertaking of various collaborative activities for establishing "Community Audit" system for Self Help Groups in West Bengal by developing sufficient number of quality "Community Auditors" for meeting the audit needs of SHGs in the state.

(b) Section 17 (2) of the Co-operative Societies Act, 1912 specifically requires the auditor to conduct an examination of the overdue debts, if any, and a valuation of the assets and liabilities of the society. The auditor of a co-operative society is also required to point out various irregularities, improprieties, and departures from the provisions of the Act, rules framed thereunder, and the bye-laws of the society.

The special features of co-operative society's audit, to be borne in mind while conducting the audit are as follows:

1) **Examination of overdue debts:** Overdue debts for a period from six months to five years and more than five years will have to be classified and shall have to be reported by an auditor. It affects its working capital position. They will have to be classified as good or bad. The auditor will have to ascertain whether proper provision for doubtful debts is made and whether the same is satisfactory. The percentage of overdue debts to the working capital and loans advanced will have to be compared with last year, so as to see whether the trend is increasing or decreasing whether due and proper actions for recovery are taken, the position regarding cases in co-operative courts, District Courts etc. and the results thereof.

2) **Overdue Interest:** Overdue interest should be excluded from interest outstanding and accrued due while calculating profit. Overdue interest is interest accrued or accruing in accounts, the amount of which the principal is overdue.

3) **Certification of Bad Debts:.** Bad debts and irrecoverable losses before being written off against Bad Debts Funds, Reserve Fund etc. should be certified as bad debts or irrecoverable losses by the auditor where the law so requires. Where no such requirement exists, the managing committee of the society must authorize the write-off.

4) **Valuation of Assets and Liabilities:** Regarding valuation of assets there are no specific provisions or instructions under the Act and Rules and as such due regard shall be had to the general principles of accounting and auditing conventions and standards adopted. The auditor will have to ascertain existence, ownership and valuation of assets. Fixed assets should be valued at cost less adequate provision for depreciation. The incidental expenses incurred in the acquisition and the installation expenses of assets should be properly capitalised. If the difference in the original cost of acquisition and the present market price is of far reaching significance, a note regarding the present market value may be appended; so as to have a proper disclosure in the light of present inflationary conditions. The current assets be valued at cost or market price, whichever is lower. Regarding the liabilities, the auditor should see that all the known liabilities are brought into the account, and the contingent liabilities are stated by way of a note.

5) **Adherence to Co-operative Principles:** The auditor will have to ascertain in general, how far the objects, for which the co-operative organisation is set up, have been achieved in the course of its working. While auditing the expenses, the auditor should see that they are economically incurred and there is no wastage of funds. Middlemen commissions are, as far as possible, avoided and the purchases are made by the committee members directly from the wholesalers. The principles of propriety audit should be followed for the purpose.

6) **Observations of the Provisions of the Act and Rules:** An auditor of a co-operative society is required to point out the infringement with the provisions of Co-operative Societies Act and Rules and bye-laws. The financial implications of such infringements should be properly assessed by the auditor and they should be reported. Some of the State Acts contain restrictions on payment of dividends, which should be noted by the auditor.

7) **Verification of Members' Register and examination of their pass books:** Examination of entries in members, pass books regarding the loan given and its repayments, and confirmation of loan balances in person is very much important in a co-operative organisation to assure that the entries in the books of accounts are free from manipulation.

8) **Special report to the Registrar:** During the course of audit, if the auditor notices that there are some serious irregularities in the working of the society, he may report these special matters to the Registrar, drawing his specific attention such irregularities. The

Registrar on receipt of such a special report may take necessary action against the society. In the following cases, for instance a special report may become necessary:

- Personal profiteering by members of managing committee in transactions of the society, which are ultimately detrimental to the interest of the society.
- Detection of fraud relating to expenses, purchases, property and stores of the society.
- Specific examples of mis-management including decisions of management against co-operative principles.
- In the case of urban co-operative banks, disproportionate advances to vested interest groups, Such as relatives of management and deliberate negligence about the recovery there of. Cases of reckless advancing, where the management is negligent about taking adequate security and proper safeguards for judging the credit worthiness of the party.

9) **Audit classification of society:** After a judgment of an overall performance of the society, the auditor has toward a class to the society. This judgment is to be based on the criteria specified by the Registrar. It may be noted here that if the management of the society is not satisfied about the award of audit class, it can make an appeal to the Registrar, and the Registrar may direct to review the audit classification. The auditor should be very careful, while making a decision about the class of society.

16.

a) Discuss the steps involve in Audit of Educational Institution.

b) Hotel Hindustan Ltd. Appoint you as an internal auditor for the year 2017-18. What point will you considered while conducting audit? --- Discuss in short.

Answer:

16. (a) The special steps involved in the audit of an educational institution are the following:

a) 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.
b) Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.
c) Check names entered in the Students' Fee Register for each month or term, with the respective class registers, showing names of students on rolls and test check amount

of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.

d) Check fees received by comparing counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.

e) Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.

f) 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, unless the Managing Committee has taken a decision to the contrary.

g) See that free studentship and concessions have been granted by a person authorised to do so, having regard to the prescribed Rules.

h) Confirm that fines for late payment or absence, etc., have either been collected or remitted under proper authority.

i) Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.

j) Verify rental income from landed property with the rent rolls, etc.

k) Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.

l) Verify any Government or local authority grant with the relevant papers of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons and compliance thereof.

m) Report any old heavy arrears on account of fees, dormitory rents, etc, to the Managing Committee.

n) Confirm that caution money and other deposits paid by students on admission have been shown as liability in the balance sheet and not transferred to revenue.

o) See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.

p) Verify that the Provident Fund money of the staff has been invested in appropriate securities.

q) Vouch donations, if any, with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilised for the purpose.

r) Vouch all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.

s) Vouch in the usual manner all establishment expenses and enquire into any unduly heavy expenditure under any head.

t) See that increase in the salaries of the staff have been sanctioned and minuted by the Committee.

u) Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.

v) Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc. These should be checked by reference to Stock Register and values applied to various items should be test checked.

w) Confirm that the refund of taxes deducted from the income from investment (interest on securities, etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income tax.

x) Verify the annual statements of accounts and while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of Staff, etc.

(b) The business of running a hotel is very much dissimilar to running an industrial unit for manufacturing of products. It is a service-oriented industry. The business is characterized by handling of large amounts of liquid cash, stock of foods providing a variety of services, and keeping watch on customers to ensure that they do not leave hotel without settling the dues. In view of these, the following matters require special attention by the auditor.

❖ **Internal Control:** Pilferage is one of the greatest problems in any hotel and it is extremely important to have a proper internal control to minimize the leakage. The following points should be checked:

- ✓ Effectiveness of arrangement regarding receipts and disbursements of cash.
- ✓ Procedure for purchase and stocking of various commodities and provisions.
- ✓ Procedure regarding billing of the customers in respect of room service, telephone, laundry, etc.
- ✓ System regarding recording and physical custody of edibles, wines, cigarettes, crockery and cutlery, linen, furniture, carpets, etc.
- ✓ Ensure that are trading accounts are prepared preferably weekly, for each sales point. A scrutiny of the percentage of profit should be made, and any deviation from the norms is to be investigated.

- **Room Sales and Cash Collections:**
  - ✓ There are various sales points scattered in a hotel and sales are both for cash and credit. The control over cash is very important. The charge for room sales is made from the guest register, and tests are to be carried out to ensure that the correct number of guests are charged for the exact period of stay. Any difference between the rate charged to the guests and standard room rent is to be investigated to see that it is properly authorized.
  - ✓ The total sales reported with the total bills issued at each sales point have to be reconciled.
  - ✓ Special care must be taken in respect of bills issued to customers who are staying in the hotel, because they may not be required to pay the bills immediately in cash but at a future date or by credit cards. Billing is to be done room-wise. It must be ensured that all customers pay their bills on leaving the hotel or within specified dates.

- **Stock:**
  The stocks in a hotel are all saleable item like food and beverages. Therefore, following may be noted in this regard:
  - ✓ All movement and transfer of stocks must be properly documented.
  - ✓ Areas where stocks are kept must be kept locked and the key retained by the departmental manager.
  - ✓ The key should be released only to trusted personnel and unauthorized persons should not be permitted in the stores area.
  - ✓ Many hotels use specialized professional valuers to count and value the stocks on a continuous basis throughout the year.
  - ✓ The auditor should ensure that all stocks are valued at the year end and that he should himself be present at the yearend physical verification, to the extent practicable, having regard to materiality consideration and nature and location of inventories

- **Fixed Assets:** The fixed assets should be properly depreciated, and the Fixed Assets Register should be updated.

- **Casual Labour:** In case the hotel employs a casual labour, the auditor should consider, whether adequate records have been maintained in this respect and there is no manipulation taking place. The wages payment of the casual labour must also be checked thoroughly.

- **Others Special Aspects:**
  - ✓ Consumption shown in various physical stock accounts must be traced to the customers' bills to ensure that all issues to the customers have been billed.
  - ✓ All payments to the foreign collaborator, it any, are to be checked.
  - ✓ Expenses and receipts are to be compared with figures of the previous year, having regard to the average occupancy of visitors and changes in rates.
  - ✓ Special receipts on account of letting out of auditorium, banquet hall, spaces for shops, boutiques, and special shows should be verified with the arrangements made.
  - ✓ In depth check should be carried out on the customers' ledgers to verify that all charges have been properly made and recovered.
  - ✓ The occupancy rate should be worked out, and compared with other similar hotels, and with previous year. Material deviations should be investigated.

Expenses for painting, decoration, renovation of building, etc. are to be properly checked. Etc.

Study Note – 12

CASE STUDY ON PERFORMANCE ANALYSIS

Learning Objective: *Performance Analysis is a task that's done repeatedly. Performance Analysis Reports are referenced at all critical decision-making junctures. These reports are used for external dealings. This chapter deals with performance analysis and its applications.*

1. Choose the correct option among four alternative answer and justify your answer:

(I) **Royalty paid on sales ₹30,000; Royalty paid on units produced ₹20,000, Hire Charges of equipment used for production ₹2,000, Design charges ₹15,000, Software development charges related to production ₹22,000. The Direct Expenses amount is :**

a. ₹88,000
b. ₹89,000
c. ₹99,000
d. ₹98,000

(II) **The Balance Sheet of X Ltd. As on 31st March 2017 showed the following information: Capital - ₹1500 lacs, Reserves - ₹696 lacs, Loans - ₹600 lacs, Sundry Creditors 774 lacs, Total assets - ₹3570 lacs. For the year 16-17, PBT - ₹900 lacs, provision for tax is ₹360 lacs and proposed dividend is ₹ 300 lacs. Return on Networth is:**

a. 30.41 %
b. 29.41 %
c. 28.41 %
d. 27.41%

(III) **Gross Sales ₹16500 lacs, Excise Duty ₹1240 lacs, Increase in stock ₹42 lacs, Cost of raw materials ₹6250 lacs, Power ₹2220 lacs, other overheads ₹ 215 lacs, Value Added is:**

a. ₹15260 Lac.
b. ₹6617 Lac.
c. ₹6533 Lac.
d. ₹15302 lac.

(IV) A cotton textile mill had cumulative waste percentage of 8% in Blow Room, 6% in Carding, 4% in Drawing, 4% in Simplex and 9% in Ring Frame. For an input of 1000 kg. of cotton in Blow Room, the output at Ring Frame is _________.

a. 735.27 Kg.
b. 725.27 Kg.
c. 745.27 Kg.
d. 755.27 Kg.

(V) Royalty paid on units produced ₹ 20,000, Hire Charges of equipment used for production ₹2,000, Design charges ₹ 15,000, Software development charges related to production ₹ 22,000. The Direct Expenses is:

a. ₹57000
b. ₹59000
c. ₹37000
d. ₹44000

(VI) Which one of the following costs appeared only in Cost Accounts?

a. Interest on mortgage and loans
b. Notional Interest on Capital
c. Dividend equalization fund, sinking, fund etc.
d. Loss due to scrapping of plan and machinery

(VII) The excisable goods not sold but used for consumption for manufacture in the production of other articles should be valued at _____________________of cost.

a. 100 %
b. 90 %
c. 110 %
d. 95 %

(VIII) Which one of the followings in an example of "Solvency Ratio"

a. Capital turnover Ratio
b. Debt Equity ratio
c. Debtors Turnover Ratio
d. None of above

(IX) Cost of Inventory does not include

a. Costs of Purchase

b. Costs of Conversion

c. Other Direct Cost

d. Administrative overheads that do not contribute to bringing inventories to their present location and condition

(X) Which one of the followings in an example of "Profitability Ratio"

a. Inventory Turnover Ratio

b. Proprietary Ratio

c. Expenses Ratio

d. Capital Gearing Ratio

(XI) Which one of the following is not an utilities.

a. Steam

b. Water

c. Compressed Air

d. Broadband internet services

Answer:

1.

(I) **₹89,000**

Direct expenses

= Royalty paid on sales+ Royalty on unites produced +Hire charges on equipment +Design Charges+ Software development charges

= ₹(30000+20000+2000+15000+22000)= ₹89,000

(II) **29.41%**

Networth =Capital +Reserves-Revaluation reserve (if any)-accumulated losses (if any)-deferred expenditure (if any)-misc. expenditure not written off (if any)

Networth =₹1500+₹696-₹360=₹1836, Total Earning =₹900-₹360=₹540

Return on Networth =₹540/₹1836=29.41%

(III) **₹6617 lac.**

Value Addition= Gross sales less Excise Duty Add Increase in stock less Cost of Raw materials less Power less Other Overheads=₹16500 – ₹1240+ ₹42 - ₹6250 - ₹2220 - ₹215 lac= ₹6617 lac.

(IV) **725.27 kg.**

Output at Ring Frame = 1000 × (100-92)% × (100-94)% × (100-96)% × (100-96)% × (100-91)% = 725.27 kgs.

(V) **₹59000/-**

Direct expenses= Royalty paid on units produced+ Hire Charges of equipment used for production+ Design charges+ Software development charges related to production = ₹20000 + ₹2000 + ₹15000 + ₹22000 = ₹59000/-

(VI) **Notional Interest on Capital.**

Any Notional Costs are appeared only in cost accounts but not entered in financial accounts as actual outlay has not occurred.

(VII) **110%.**

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

(VIII) **Debt Equity ratio**

Debt Equity ratio represent the long term solvency position of an entity. It is a ratio of debt to equity representing ratio of debt in capital structure.

(IX) **Administrative overheads that do not contribute to bringing inventories to their present location and condition**

(IV) Costs that are excluded from inventory valuation Certain costs are excluded in valuing inventory are:-

- Abnormal amounts of wasted materials, labor, or other production costs
- Storage costs unless they are essential to the production process

Administrative overheads that do not contribute to bringing inventories to their present location and condition etc.

(X) **Expenses**

Expenses Ratio is a profitability ratio with respect to sales. It is a ratio of a particular expense to sales.

(XI) **Broadband internet services.**

The term 'Utilities' refer to significant inputs such as power, steam, water, compressed air and the like which are used for manufacturing process but do not form part of the final product.

2.

TATA STEEL LTD. has the following Balance Sheet as on March 31, 2017 and March 31, 2016

(Amount in ₹ Lakh)

Year ended March 31	2017	2016
SOURCES OF FUNDS:		
Shareholders' Fund	2,972	1,886
Loan Funds	4,644	4,060
	7,616	5,946
APPLICATIONS OF FUNDS:		
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 TATA STEEL LTD. for the year that ended is as follows:

(Amount in ₹ Lakh)

Year ended March 31	2017	2016
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	41	347

Required:

(I) Calculate for the year 2016-17:

a) Inventory Turnover Ratio

b) **Return on Net Worth**
c) **ROI**
d) **ROE**
e) **Profitability Ratios**

(II) Give brief comments on the financial position of company.

Answer:

2. (a) The following figures are extracted from the statement prepared by the Cost Accountant and the Trial Balance of ABC Ltd., which is a single product company calculate Value Added:

	₹ in lacs 31.03.2017
Gross sales inclusive of Excise Duty	2,040
Excise Duty	300
Raw Materials consumed	1,140
Direct Wages	35
Power and Fuel	30
Stores and Spares	6
Depreciation Charged to production cost centres	16
Factory Overheads:	
Salaries and wages	5
Depreciation	2
Rates and Taxes	1
Other Overheads	6
Administrative Overheads:	
Salaries and Wages	10
Rates and Taxes	2
Other Overheads	162
Other overheads	7
Selling and Distribution overheads:	
Salaries and Wages	6
Packing and Forwarding	1
Depreciation	124
Other overheads Interest	85
Bonus and Gratuity	12
Gross Current Assets	840
Other overheads Interest	324

Answer:

2. (a)

(i) Various Ratios for the year 2016 – 2017

(a) Inventory Turnover Ratio= Cost of Goods sold/Average inventory
=25152/3284=7.66

(b) Return on Net Worth=Profit after Tax/Net Worth
=40/2972*100=1.35%

(c) ROI=Net profit before interest but after tax/Average Capital employed
=296/6781*100=4.37%
Net profit before interest but after tax=256+40=296
Average capital employed=(7616+5946)/2=6781

(d) ROE= PAT available to Equity Share holders/Average shareholders" Funds
=40/2429=1.65%
Average shareholders" Funds=(2972+1886)/2=2429

(e) Profitability Ratios:
Gross Profit Ratio = (1,566/26,718) X 100 = 5.86%
Operating Profit Ratio = (68+256) =(324 /2, 6718) X 100 =1.21%
Net Profit Ratio=(40 /2,6718) X 100 = 0.15%.

(ii) **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 2016-17 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.

(b)

Net Sales	1,740
Less: (i) Cost of Bought out Materials & Service (Raw Materials and Stores & Spares)	1,146
(ii) Power & Fuel, other bought out services	30
(iii) Overheads (excluding Salaries & Wages, Rates & Taxes and depreciation)	298
(Y) = (i) + (ii) +(iii)	1,474
Value Addition : (X) –(Y) =	266

3.

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

The year ended March 31.	2016-17	2015-2016
Rated Capacity per Hr (in MT)	80	80
Break down (Hrs)	2,177	1,01
Planned Maintenance (Hrs)	247	422
Power restrictions (Hrs)	1,237	1,48
Shortfall (there are no orders) (Hrs)	792	677
Want of wagons (Hrs)	495	635
Total stoppage (Hrs)	4,948	4,23
Total running (Hrs)	3,888	4,58
Total available Hours	8,836	8,81
Production during the year (in MT)	2,48,844	3,29,92
Hourly Rate of Production (in MT)	64	72
Capacity Utilization (%)	62.21	82.48
Annual Installed Capacity (in MT)	4,00,000	4,00,000

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

(i) The performance of the company

(ii) Your suggestion for improvement.

b) RAJA CEMENT LTD. has a captive power generation plant for its cement factory. The following information is available with regard to the power generation for the year ended March 31, 2017:

Coal consumption	2400 tonne @ ₹ 600 per tonne
Oil	3000 liters @ ₹ 50 – 50 per litre
Water	24000 gallons at ₹ 60 per gallon
Stores and Other Consumables	₹ 55,000

Salaries of power generating plant:

2 supervisors each at ₹10,600 p.m., 5 skilled workers each at ₹6,100 p.m., 3 helpers each at ₹ 4,200 p.m. Salaries to boiler house attendant, 8 workers, each at ₹4,200 p.m. Cost of power generating plant— ₹15,00,000 having life of plant 15 years with ₹ 60,000 residual value. Cost of Boiler plant— ₹6,00,000 having life of plant 10 years with no residual value.

Miscellaneous income received by sale of ash— ₹ 50,000. Repair and maintenance— Power generating plant ₹ 1,50,000, Boiler house ₹ 1,26,000. Share of Administrative Overhead— ₹ 1,35,000.

Power generated during the year: 3024250 KWH.

Note: No power generated is used by the power generated plant itself.

You are required to prepare the Cost Sheet to calculate cost per kWh of electricity generated as per the Companies (Cost Records and Audit) Rules 2014.

Answer:

3. (a)

(i) Performance of the Company:

(a) Rated capacity = 80 MT/Hr : Rated capacity achieved in 2012-13=(72/80)x100 =90% Rated capacity achieved in 2013-14= (64 /80)x100 = 80%

The capacity achievement as % of rated capacity has declined from 90% to 80% in 2013-14.

Further the Capacity Utilization has gone down to 62.21% in 2013-13 from 82.48% of Previous year; a reduction of 20.27%

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

1. Breakdown hours have gone up from 1,015 hours to 2,177 hrs, an increase by 114.48%
2. Planned Maintenance hrs has reduced from 422 hrs to 247 hrs i.e. by 41.47%
3. Shortfall hrs due to lack of orders has increased from 677 hrs to 792 hrs i.e. by 16.99%
4. The total stoppage hrs. has increased from 4,230 hrs to 4,948 hrs i.e. by 16.97%
5. The total running hrs has come down from 4,582 hrs to 3,888 hrs i.e. by 15.15%
6. The production has come down from 3,29,928 Mt to 2,48,844 Mt i.e. by 24.58%

From the above findings, it can be pointed out that the underutilization of capacity to the extent of little over 20% can be attributed mainly to:-

- Increased total stoppage hours of 4,948 of 2013-14 as against that of 4,230 hrs in 2012-13and
- The net increase of 718 hrs (4,948-4,230) is again due to increase of break down by 1,162 hrs (2,177-1,015) in the year 2013-14

(ii) Suggestion:

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

(b)

RAJA CEMENT LTD

STATEMENT SHOWING COST OF POWER GENERATED BY POWER GENERATED PLANT

FOR YEAR ENDED

Power generated			3024250 kwh
Particulars		Total Amount (₹)	Cost Per Kwh (₹)
Coal consumption (2400 × 600)	1440000		
Less: Sale of Ash	50000	1390000	0.46
Oil 3000 litres at ₹ 50.50 per ltr.		151500	0.05
Water 24000 gallans at ₹60/- per gallan		1440000	0.48
Stores and other consumables		55000	0.02
Salaries of generating plant			
Supervisor (2 ×10600×12)	254400		
Skilled Worker (5 × 6100 ×12)	366000		
Helpers (3 x 4200×12)	151200	771600	0.26
Salaries To Boiler House Attendant (8× 4200 ×12)		403200	0.13
Repairs and maintenance Generating plant	150000		
Boiler house	126000	276000	0.09
Depreciation			
Generating Plant (1500000-60000)/15Yrs.	96000		
Boiler House (600000/10Yrs.)	60000	156000	0.05
Share of administrative overhead		135000	0.04
Total cost of power generated		4778300	1.58

So, Cost per KWH of Electricity generated = ₹1.58

4.

a) Purchase of Materials ₹ 3,00,000 (inclusive of Trade Discount ₹ 3,000); Fee on Board ₹ 12,000; Import Duty paid ₹ 15,000; Freight inward ₹ 20,000; Insurance paid for import by sea ₹ 10,000; Rebates allowed ₹ 4,000; Cash discount ₹ 3,000; CENVAT Credit refundable ₹ 7,000; Subsidy received from the Government for importation of these materials ₹ 20,000. Compute the landed cost of material (i.e. value of receipt of material).

b) The Cost Accountant of BASANTI DEVI RICE 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:

	Particulars'	Amount(₹)
(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.

Answer:

4. (a)

Computation of Material Cost Sheet

	Particulars	Amount (₹)
	Purchase price of Material	3,00,000
Add:	Fee on Board	12,000
Add:	Import Duties of purchasing the material	15,000
Add:	Freight Inward during the procurement of material	20,000
Add:	Insurance paid	10,000
	Total	**3,57,000**
Less:	Trade Discount	3,000
Less:	Rebates	4,000
Less:	CENVAT Credit refundable	7,000
Less:	Subsidy received from the Government for importation of materials	20,000
	Value of Receipt of Material	**3,23,000**

Note:

- ✓ Cash discount is not allowed, as it is a financial item.
- ✓ Subsidy received, rebates and CENVAT Credit refundable are to be deducted for the purpose of computing the material cost.

(b)

RECONCILIATION OF PROFIT BETWEEN COST AND FINANCIAL ACCOUNTS
FOR THE YEAR ENDED ON 31ST MARCH, 2018

Particulars'	Amount	Amount
Profit as per Financial Accounts:		22,14,100
Add: Loss on sale of investments	33,600	
Add: Voluntary Retirement compensation included in salary	50,25,000	
and wages in F/A - Not included in cost A/c	75,000	51,33,600
Add: Donation paid		73,47,700
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	53,37,200
Profit as per Cost Accounts		20,10,500

5.

a) (i) **Purchase of material $ 50,000 [Forward contract rate $ = 54.40 but $ = 54.60 on the date of importation]; Import Duty paid ₹ 5,65,000; Freight inward ₹ 1,62,000; Insurance paid for import by road ₹ 48,000; Cash discount ₹ 33,000; CENVAT Credit refundable ₹ 37,000; Payment made to the foreign vendor after a month, on that date the rate of exchange was $ = 55.20. Compute the landed cost of material.**

(ii) **A factory operates a standard cost system, where 2,000 kgs of raw materials @ ₹12 per kg were used for a product, resulting in price variance of ₹6,000(F) and usage variance of ₹3,000(A). Then what will be the standard material cost of actual production?**

b) **MANAKSIA CO. LTD. a single product manufacturing company, has following four operations undergone by a product under Cost Audit.**

The Process wise Input, Output, Direct Employee Costs and Direct Material Costs for the year ended March 31, 2016 are given below:

Process	Input Unit	Output Unit	Direct employee Cost of the process (₹)	Direct Material Cost of the process (₹)
MP-I	312000	280800	8,42,400	11,23,200
MP-2	330000	297500	11,90,000	13,38,750
MP-3	414000	397500	19,87,500	16,89,375
MP-4	390000	361000	28,88,000	23,82600

You are required to calculate:

(i) Direct Employee Cost per unit of the product,

(ii) Direct Material Cost per unit of the product,

-- Under reference as required in (PART-B, PARA-2) of the Annexure to Cost Audit Report under the Companies (Cost Records and Audit) Rules, 2014.

Answer:

5. (a)

(i) Computation of Landed Cost of Material

Particulars	₹
Purchase price of material [50,000 × 54.60]	2730000
Add: Import Duties of purchasing the material	565000
Add: Freight Inward during the procurement of material	162000
Add: Insurance of the material (In case of import of material by road/ Sea)	48000
Total	**3505000**
Less: CENVAT Credit refundable	37000
Value of Receipt of Material	**3468000**

(ii) Total material cost variance = Material price variance +Material usage variance
= 6,000(F) + 3,000(A)
= 3,000(F)

Actual material cost = 2,000x12
= ₹ 24,000

Hence, the standard material cost of actual production = 24,000 + 3,000(F) = ₹ 27,000

(b) Total employee cost per unit and total material cost per unit of the product under Audit mist be an aggregation of process wise employee cost and material costs after taking into account the good units occurring in each process.

Process	Input (unit)	Output (unit)	Factor
Mp-1	312000	280800	312000÷280800=1.1111
MP-2	330000	297500	330000÷297500=1.1092
MP-3	414000	397500	414000÷397500=1.0415
MP-4	390000	361000	390000÷361000=1.0803

A)Process wise Employee costs per unit of output (Product) are:	B) Process wise material cost per unit of output (product) are:
MP-1= 842400÷280800= ₹3	1123200÷280800=₹4.00
MP-2= 1190000÷297500=₹4	1338750÷297500=₹4.50
MP-3= 1987500÷397500=₹5	1689375÷397500=₹4.25
MP-4= 2888000÷361000=₹8	2382600÷361000=₹6.60

(I) Aggregating all above (A) employee cost to the finished product form process MP-4 will be:

Process MP-1	= ₹3.00	
Process MP-2	= ₹3×1.1092+4	= ₹7.3276
Process MP-3	= ₹7.3276×1.0415+5	=₹12.6317
Process MP-4	= ₹12.6317×1.0803+8	=₹21.6460

Direct employees cost per unit of finished product (output) in ₹21.65

(II) Aggregating all above (B), material costs to the finished product from process MP-4 will be:

Process MP-1	= ₹4.0000	
Process MP-2	= ₹4.00×1.1092+4.50	= ₹8.9368
Process MP-3	= ₹8.9368×1.0415+4.25	=₹13.5577
Process MP-4	= ₹13.5577×1.0803+6.60	=₹21.2464

Hence, direct material cost per unit of finished product (output) is ₹21.25

6.

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

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

Calculate the process wise Waste Multiplier factors.

b) Trial Balance as on 31.3.2017 (relevant extracts only)

Particulars	₹	Particulars	₹
Materials consumed	2500000	Special Subsidy received from Government towards Employee salary	275000
Salaries	1500000	Recoverable amount from Employee out of perquisites extended	35000
Employee training cost	200000		
Perquisites to Employees	450000		
Contribution to Gratuity Fund	400000		
Lease rent for accommodation provided to employees	300000		
Festival bonus	50000		
Unamortised amount of Employee cost related to a discontinued operation	90000		

Compute Employee Cost as per CAS 7

Answer:

6. (a)

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

(b)

Computation of Employee Cost

	Particulars	₹
	Salaries	1500000
Add	Net Cost of Perquisites to Employees =Cost of Perquisites (-) amount recover able from employee = 4,50,000 (-) 35,000	415000
Add	Lease rent paid for accommodation provided to employee	300000
Add	Festival Bonus	50000
Add	Contribution to Gratuity Fund	400000
Less	Special subsidy received from Government towards employee salary	(275000)
	Employee Cost	**2390000**

7.

a) What do you mean by Waste Multiplier?

b) What do you mean by Installed Capacity and Normal capacity with respect to CAS – 2?

c) In a manufacturing shop, product P requires 2 man hours and Product Q requires 6 manhours. In a month of 26 working days of 8 hours a day 2000 unit of P and 1000 unit of Q were produced. The Company employs 60 workers in the shop and the budgeted man-hours are 1,08,000 for the year. You are required to workout capacity ratio, activity ratio and efficiency ratio.

Answer:

7. (a) Waste multiplier is that quantity of output from any process, which will be needed to get one unit of final output.

For example the output of Blow Room goes to Carding and usable waste of Carding goes back to the cotton mix in Mixing and Blow Room and so on. The 'back' and 'forth' waste movement are given due consideration while calculating the raw material cost. The realization of saleable waste is given due credit in the cost of raw material consumed.

(b) Installed capacity is the maximum capacity of producing goods or providing services, determined either based on technical specification of the facility or through a technical evaluation.

Normal capacity is the volume of production or services achieved or achievable on an average over a period under normal circumstances taking into account the reduction in capacity resulting from planned maintenance.

(c) Budgeted hours for the year

= 108000 Hrs for the year

= 9000 for the month

Maximum possible hours

= 26x8x60 workers = 12480 Hrs

Actual hours worked

= Maximum possible hours worked = 12480 Hrs.

Standard hours produced

Product P = 2000 x 2 = 4,000 Hrs.

Product Q = 1000 x 6 = 6,000 Hrs.

Total (4000 Hrs. + 6000 Hrs.) = 10,000 Hrs.

Capacity ratio Standard capacity usage ratio

= Budgeted/maximum possible hours x 100 = 9000/12480 x 100 = 72.12%

Actual capacity usage ratio

= Actual hour worked/maximum possible hours = 12480/12480 x 100 = 100.00%

Activity Ratio

= Actual production in terms of Standards Hrs/Budgeted Hrs.

= 10000/9000x100 = 111.11%

Efficiency Ratio

= Actual production in Standard Hour / Actual hours worked

= 10000/12480 x 100 = 80.13%

8.

a) VIKRANT LTD. in the business of Real Estate and Consumer Goods shows the following financial position for the year ending March31, 2017:

Particulars	Year ended 31st March	
	2017	2016
Liabilities		
Share Capital	33	33
Securities Premium Account	931	928
General Reserve	57	44
Capital Redemption Reserve	42	40
Profit & Loss Account	595	390
Long Term Borrowings	1013	670
Deferred Tax Liability	25	39
Short Term Borrowing	780	676
Trade Payable	715	747
Miscl. Provisions	77	73
Total:	4268	3640
Assets:		
Fixed Assets (Tangible)	647	614
Capital WIP	667	383
Non-Current Investments	2378	2048
Long Term Loans	53	66
Inventories	167	232
Trade Receivables	104	94
Cash and Bank Balance	107	69
Other Current Assets	27	30
Advance for Equipment	122	104
Total:	4272	3640

Profit before tax for the year 2016-17 was ₹326 crores (Previous year ₹397 Crores)

You are required to compute the following figures/ratios as stipulated in PART-D, PART-4 to Annexure of cost Audit Report under the Companies (Cost Records and Audit) Rules, 2014 for the year ended 31st March, 2017:

(i) Capital Employed

(ii) Net Worth

(iii) Debt Equity Ratio

(iv) PBT to Capital Employed

(v) PBT to NET Worth

(vi) Current Assets to Current Liabilities

b) ARCVAC LTD., a manufacturing company provides the following extracts from its records for the year ended March 31, 2017.

The Company's specifications—Capacity for the machines per hour	2000 units
No of shifts (each shift of 8 hours) per day	3 shifts
Paid holidays in a year (365 days):	
(i) Sunday	52 days
(ii) Other holidays	13 days
Annual maintenance is done within these 13 holidays.	---
Preventive Weekly Maintenance for the Machines is carried on during Sundays. Normal idle capacity due to Lunch time, shift changes etc. per shift.	1 hour
Production based on sales expectancy in past 5 years (units in Lakh):	90.80
	104.90
	78.46
	93.56
	91.30
Actual Production for the year ended March 31, 2015 (units in Lakh):	97.80

You are required to calculate:

(1) Installed Capacity

(2) Actual Capacity

(3) Normal Capacity

(4) Idle Capacity

(5) Abnormal Idle Capacity-Keeping in view of the relevant Cost Accounting Standard (CAS-2).

Answer:

8. (a)

Year ended March 31			2016	2017	2017
(i) Capital Employed:					
Fixed assets (Tangible)			614	647	
Non-current investments			<u>2048</u>	<u>2378</u>	
Particulars	Previous Year 2016	Current Year 2017	2662	3025	
Current Assets:					
(A) Inventories	232	167			
Trade Receivables	94	104			
Cash and Bank Balance	69	107			
Other Current Assets	<u>30</u>	<u>27</u>			
(A)	425	405			
Current Liabilities: Short	676	780			
term borrowings Trade	747	715			
payables	73	77	<u>(1071)</u>	<u>(1167)</u>	
Misc. Provision	1496	1572	<u>1591</u>	<u>1858</u>	
(B)					
Working Capital (A-B)					
CAPITAL EMPLOYED			(1591+1854)÷		1722.5
Average capital employed for the year ended March 31,2017			2		

(ii) NetWorth : (For the year ended Mar 31, 2017		33	
Share capital		931	
Securities premium a/c General reserve		57	
Capital redemption reserve		42	
Profit and loss account		<u>595</u>	1658
(iii) Debt (For the year ended March 31, 2017) Long			
Term Borrowings		1013	
Deferred Tax Liabilities	(1038÷1658)	<u>25</u>	<u>1038</u>
Debt Equity Ratio: (1038/1658) = 62.60%	=62.60%		62.6:100
= 62.6:100 or 0.63:1		Or	0.63:1
Profit before tax March 31, 2016			326
(PBT) for the year Ended			
(iv) PBT to Capital Employed:	(326÷1722.5)×100		18.93%

(v) PBT to Net Worth	(326÷1658)×100		19.66%
(vi)CurrentAssetstoCurrentLiabilities:for2017 (CA/CL) =(403/1574)		Or	0.256 0.26:1

(b)

1	Installed Capacity	365×8×3×1800=175.20 lakh units
2	Actual Capacity Utilization	[(97.80)÷157.68] × 100 = 62.02%
3	Normal Capacity	(104.90 + 93.56 + 91.30)/3 = 96.59 lakh unit
4	Idle Capacity	(157.68 – 97.80) = 59.88 lakh units (59.88)÷157.68 = 0.3798 = 0.3798 i.e. 37.98%
5	Abnormal idle	(113.40–97.80)=15.60 lakh units i.e., or (15.60/113.40)=
	Capacity	13.76%

9.

a) The following is a summary of the Profit and Loss Account of M/s. Videocon Limited for the year ended 31.03.2018. There was a major breakdown of machinery resulting in loss of production for 42 days, in June and July, 2016 and a labour strike for 97 days from 14.2.2017 to 21.5.2017. The Company produced a single product (Steel-Billet) and the production during the year was 942000 kgs.

Sales		**13,540**
Cost of Sales:	**5,600**	
Raw Materials,	**830**	
Stores and Spares Excise Duty	**1,400**	
Salaries and Wages Power and Fuel	**470**	
Repairs and Maintenance:	**35**	
Major Breakdown	**94**	
Repairs Other regular maintenance	**320**	
Carriage Outwards Insurance General	**34**	
Insurance-Transit	**22**	
Advertisement and Sales Promotion	**720**	
Rent, Rates and Taxes	**97**	
Printing, Stationery etc.	**437**	
Travelling and Conveyance	**776**	
Other Administrative expenses	**426**	
Depreciation	**391**	
Interest	**1,494**	
		13,146
Profit		**394**

You are required to compute the amount of abnormal cost on account of the breakdown and strike and the impact on cost per unit of output. Where do these figures find a place in the Cost Audit Report?

Answer:

9. (a) Period Costs incurred when there is no production are deemed as abnormal and the costs apportioned for such periods are excluded from cost of production of the product.

Particulars	in lakh
Salaries & Wages	1,400
General Insurance	34
Rent, rates & taxes	97
Other administrative expenses	426
Depreciation	391
Interest	1,494
Total Fixed Cost	3,842

Total period of production stoppage:

Due to machinery breakdown	42days
Due to strike 14.02.2014 to 31.03.2014	46days
	88 days

Fixed Costs apportioned to the period of production stoppage

= ₹ 3842 lakhs x 88 / 365	₹ 926.29lakhs
Major breakdown repair	₹35.00lakhs
Total abnormal cost	₹ 961.29 lakhs

This work out to approximately 9.85%of the total cost of production and should be excluded from the respective elements of cost in the cost sheets and should be stated in Reconciliation Statement of Para 2, PART D of the Annexure to the Cost Audit Report.

The abnormal cost included in Cost of Production is ₹ 9,61,29,000/9,42,000 = ₹ 102.05 per Kg.

Working Note:

Cost of Production:

	in lakhs
Raw Materials, Stores and Spares	5,600
Salaries & Wages	1,400
Power & Fuel	470
Repairs and Maintenance	129
Insurance General Rent,	34
Rates & Taxes Printing,	97
Stationery	437
Travelling & Conveyance Other	776
Admn. Exp. Depreciation	426
	391
Cost of Production	9,760

Abnormal cost=961.29*100/9760=9.85%

Note:

- ✓ Excise Duty is not forming part of Cost of Material.
- ✓ Carriage outward and insurance in transit are considered not forming part of cost of production.
- ✓ Advertisement and Sales Promotion and Interest are not forming part of Cost of Production.

10.

a) Electrocon LTD. is engaged in the manufacture of LED TV sets having its factories at Patna and Gujarat. The company manufactures picture tube at Patna which is consumed to produce LED TV sets at Gujarat factory. The following information pertaining to captively consumed picture tubes are extracted from the records of the company for the Half year ended March 31, 2017.

Amount in ₹ thousand

Direct material inclusive of excise duty ₹ 94 thousand	**1,044**
Direct wages and salaries	**357**
Direct expenses	**80**
Indirect materials	**70**

Factory overheads	320
Administrative overheads (20% relating to production activities)	640
Quality control cost	100
Research and development cost	125
Selling and distribution expenses	225
Sale of scrap realized	130
Profit margin	15%

You are required to determine:

- ✓ **The cost of production for purpose of captive consumption in terms of Rule-8 of the Central Excise Valuation (Determination of price of Excisable Goods) Rules and as per CAS-4, and**
- ✓ **Also Assessable Value for the purpose of paying excise duty on Captive Consumption**

b) **AMBUJA CEMENT LTD. has a captive power generation plant for its cement factory. The following information is available with regard to the power generation for the year ended 31st March, 2017:**

Coal consumption	2400 tonnes @ ₹600 per tonne
Oil	3000 liters @ ₹50-50 per litre
Water	24000 gallons at ₹60 per gallon
Stores and other consumables	₹ 55,000

Salaries of power generating plant:
2 supervisors each at ₹10,600 p.m., 5 skilled workers each at ₹6,100 p.m., 3 helpers each at ₹ 4,200 p.m.

Salaries to boiler house attendant, 8 workers, each at ₹4,200 p.m.
Cost of power generating plant— ₹15,00,000 having life of plant 15 years with ₹ 60,000 residual value.

Cost of Boiler plant— ₹6,00,000 having life of plant 10 years with no residual value. Miscellaneous income received by sale of ash— ₹ 50,000.

Repair and maintenance— Power generating plant ₹ 1,50,000, Boiler house ₹ 1,26,000. Share of Administrative Overhead— ₹ 1,35,000.

Power generated during the year: 3024250 KWH.

Note: No power generated is used by the power generated plant itself.

You are required to prepare the Cost Sheet to calculate cost per kWh of electricity generated as per the Companies (Cost Records and Audit) Rules 2014 for the year ended March 31, 2018.

Answer:

10. (a)

Computation of Cost of Production (As per CAS 4)

Amount in ₹ thousand

Direct materials (exclusive of excise duty (1044-94)	950
Direct wages and salaries	357
Direct expenses	80
Factory overheads (320+70)	390
Quality control cost	100
Research and development cost	125
Administrative overheads (to the extent relates to Production activities)	128
Less: sale of scrap realized	(130)
Cost of production	**2000**
Add: 10% as per rule 8 of CEV (DPEG) Rules (10% of 2000)	200
Assessable Value as per rule 8 of the CEV (DPEG) Rules	**2200**

(b) Statement Showing Cost Of Power Generated By Power Generated Plant For Year Ended 31st March, 2018

Power generated			3024250 kwh
Particulars		Total Amount (₹)	Cost Per Kwh (₹)
Coal consumption (2400 × 600)	1440000		
Less: Sale of Ash	50000	1390000	0.46
Oil 3000 litres at ₹ 50.50 per ltr.		151500	0.05
Water 24000 gallans at ₹60/- per gallan		1440000	0.48
Stores and other consumables		55000	0.02
Salaries of generating plant			
Supervisor (2 ×10600×12)	254400		
Skilled Worker (5 × 6100 ×12)	366000		
Helpers (3 x 4200×12)	151200	771600	0.26
Salaries To Boiler House Attendant (8×4200 ×12)		403200	0.13

Repairs and maintenance Generating plant Boiler house	 150000 126000	 276000	 0.09
Depreciation Generating Plant (1500000-60000)/15Yrs. Boiler House (600000/10Yrs.)	 96000 60000	 156000	 0.05
Share of administrative overhead		135000	0.04
Total cost of power generated		4778300	1.58

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA
(Statutory body under an Act of Parliament)

Website : www.icmai.in
Email: studies@icmai.in
Toll Free: 1800 345 0092 / 1800 110 910

Follow us on

HEADQUARTERS
CMA Bhawan
12, Sudder Street, Kolkata - 700 016
Ph: +91-33-2252-1031/34/35/1602/
1492/1619/7373/7143
Fax: +91-33-2252-7993/1026/1723

DELHI OFFICE
CMA Bhawan
3, Institutional Area, Lodhi Road
New Delhi - 110003
Ph: + 91-11-24666100/24666124/24666122
Fax: +91-11-43583642

Behind Every Successful Business Decision, there is always a CMA