FINAL EXAMINATION

GROUP IV

(SYLLABUS 2012)

SUGGESTED ANSWERS TO QUESTIONS

DECEMBER 2013

Paper- 19: COST AND MANAGEMENT AUDIT

Time Allowed : 3 Hours **Full Marks : 100**

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

The paper is divided in three sections.
From Section A answer any four questions (4x15=60 marks)
From Section B answer any two questions (2x10=20 marks)
From Section C answer any two questions (2x10=20 marks)

SECTION A (60 Marks)

Answer any four Questions

15x4=60

1. (a) MNC Sugar Mill Ltd. located at Uttar Pradesh has a boiler which is used for its own by product, Bagasse, as fuel. The steam generated is first used for generation of power and the exhaust steam is used in the process of sugar manufacture. The following details are extracted from the financial accounts and cost accounting records of the MNC Sugar Mill:

Sugar Produced	2870000	Quintals
Steam generated and consumed	1465000	Tones
Fuel (Bagasse) consumed for production of steam	685000	Tones
Cost of Generation of Steam including cost of water (other than Fuel Cost)	₹ 64530000	
Steam used for generation of power	620000	Tones
Power Purchased from Electricity Board @ ₹ 5.40 per KWH	5270000	KWH
Power Generated from Steam Turbine	48525000	KWH
Variable conversion cost of generation of power (excluding cost of steam)	42218000	

Notes: (1) The Sale Value of Bagasse, if sold in the open market is ₹ 1820/- per Tonne.
(2) The Exhaust steam (after generation of power) transferred to sugar manufacturing process is 82% of the cost of production of Steam.

Prepare two separate cost sheet for steam and power as per Cost Accounting Record Rules and compute the average cost of power as per Cost Audit Report. 12

(b) Define direct expenses as per CAS 10. How are they identified? 3

Answer:

1. (a)

Cost of Steam

Cost of Fuel - Bagasse (6,85,000 tonnes @ ₹ 1820 per tonne)	₹	1,24,67,00,000
Conversion Cost including Cost of water	₹	6,45,30,000
Total Cost	₹	1,31,12,30,000
Steam generated (Tonnes)		14,65,000
Gross Cost of steam per Tonne (1,31,12,30,000 / 14,65,000)	₹	895.04
Steam directly used for sugar production = (14,65,000 – 6,20,000) tonnes × 895.04 =	₹	75,63,08,800(A)
Value of exhaust steam from steam turbine At 82% of cost = 6,20,000 × 895.04 × 82% =	₹	45,50,38,336(B)
Total cost of steam used for Sugar Production (A+B) =	₹	1,21,13,47,136
Average cost of steam per tonne (1,21,13,47,136 / 14,65,000)	₹	826.86

For disclosure in Para 5 of the Annexure to the Cost Audit Report:

Steam Consumption per quintal of sugar = 14,65,000 / 28,70,000 = 0.51 tonnes

Steam cost per quintal of sugar = 1,21,13,47,136 / 28,70,000 = ₹422.07

Cost of Power

Cost of high pressure steam sent to steam turbine = 62,00,000 tonnes × ₹ 895.04	₹	55,49,24,800
Conversion cost for generation of Power	₹	4,22,18,000
Total	₹	59,71,42,800
Less : Credit for exhaust steam transferred to sugar manufacture in Steam Cost	₹	45,50,38,336
Net cost of Power generated	₹	14,21,04,464
Power generated		4,85,25,000 KWH
Cost of Power generated	₹	2.93 per KWH

For disclosures in Para 5 of the Annexure to the Cost Audit Report:

Quantity & Cost of Power	KWH	₹	₹ /KWH
(a) Own generation	4,85,25,000	14,21,04,464	2.93
(b) Purchased	52,70,000	2,84,58,000	5.40
	5,37,95,000	17,05,62,464	3.17

Power consumed per quintal of sugar = (5,37,95,000 / 28,70,000) = 18.74 KWH
Power cost per quintals of sugar = (18.74 KWH × 3.17) = ₹ 59.41

Note: The figure for the year under audit and figures for the immediately preceding financial year are required to be provided.

(b) Direct Expenses are expenses relating to manufacture of a product or rendering a service, which can be identified or linked with the cost object other than direct material cost and direct employee cost. Examples of Direct Expenses are royalties charged on production, job charges, hire charges for use of specific equipment for a

specific job, cost of special designs or drawings for a job, software services specifically required for a job, travelling Expenses for a specific job.
Identification of Direct Expenses shall be based on traceability in an economically feasible manner.

Direct expenses incurred for the use of bought out resources shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of trade discounts, rebates, taxes and duties refundable or to be credited.

Direct expenses other than those incurred for the use of bought out resources shall be determined on the basis of amount incurred in connection therewith.

Direct Expenses paid or incurred in lump-sum or 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.

2. (a) How would you treat the following as per CAS 9 related to packing material cost? . 6

(i) Primary and Secondary packing material cost.

(ii) Self manufactured packing material.

(iii) The forex component of imported packing material.

(b) The following figures relate to usage of power for a product:

	2010 -11	2011-12	2012 -13
Total power consumed to KWH Rate KWH ₹	2402474 2.29	2494872 2.12	2175677 1.90
Total production in million kgs.	337.73	333.084	300.865

Compute necessary productivity measures and compare the efficiency of power usage during the three years. 6

(c) As a Cost Auditor you find that indicative Break-even Point is higher than Actual Sales. Give your suggestions for improvements. 3

Answer:

2. (a) (i) Cost of primary packing materials shall form part of the cost of production. Cost of secondary packing materials shall form part of distribution overheads.

(ii) Self manufactured packing materials shall be valued including direct material cost, direct employee cost, direct expenses, job charges, factory overheads including share of administrative overheads comprising factory management and administrative and share of research and development cost incurred for development improvement of existing process or product.

(iii) The forex component of imported packing material cost shall be converted at the rate on the date of the transaction. Any subsequent change in the exchange rate till payment or otherwise shall not form part of the packing material cost.

(b)

	2010-11	2011-12	2012-13
Power consumed in Kwh	24,02,474	24,94,872	21,75,677
Rate per Kwh (₹)	2.29	2.12	1.90
Total Power cost (₹)	55,01,665	52,89,129	41,33,786
Production (in million kgs)	337.730	333.084	300.865
	(337730 MT)	(333084 MT)	(300865 MT)
Power cost/MT (₹)	16.29	15.88	13.74
Power usage MT (KWH)	7.11	7.49	7.23

Variances over previous year:

Rate (₹)	4,24,128 (F)	4,78,649 (F)
Volume (₹)	75,683 (F)	5,11,638 (F)
Usage (₹)	2,87,275 (A)	1,65,056 (F)
	2,12,536 (F)	11,55,343 (F)

Calculation of variances:

Rate variance:

	2010-11	2011-12	2012-13
Total power consumed (Kwh)	24,02,474	24,94,872	21,75,677
Rate per Kwh ₹	2.29	2.12	1.90
Rate variance		24,94,872×(2.29-2.12) = ₹4,24,128 (F)	21,75,677×(2.12-1.90) = ₹4,78,649 (F)
Production in Million Kgs	337.730	333.084	300.865

Volume variance:

2012-13 & 2011-12 (333084 – 300865) × 15.88 = ₹5,11,638 (F)

2011-12 & 2010-11 (337730 – 333084) × 16.29 = ₹75,683 (F)

Usage variance:

2012-13 & 2011-12

11,55,343 – 4,78,649 – 5,11,638 = ₹1,65,056 (F)

2011-12 & 2010-11

2,12,536 – 4,24,128 – 75,683 = ₹2,87,275 (A)

Total variance:

2012-13& 2011-12 52,89,129 – 41,33,786 = ₹11,55,343 (F)

2011-12 & 2010-11 55,01,665 – 52,89,129 = ₹2,12,536 (F)

(c) The Cost Auditor has to see the followings and give his suggestions after going into following details:

i) Deployment of manpower has been properly done or not and the Fixed Cost can be reduced.

ii) Production capacity has been utilised properly or not and increase in Production amounts to absorption of fixed cost more effectively.

iii) Actual Sales can be increased by proper marketing. Monthly review can be made with targeted sales budget. Responsibility can be fixed on department heads.

iv) Check point should be established for Key areas where cost auditor helps the management by plotting the areas.

3. (a) Para 9 of the Companies (Cost Audit Report) Rules 2011 requires disclosure of "Cost of Production" and "Cost of Sales" at a company level. How the same would be available when all the products/activities are not covered under cost audit? 3

(b) What disclosures are required to be made in Cost statement as per CAS-8 as regards to utility? 5

(c) Are there any sectors exempted under Companies (Cost Accounting Records) Rules 2011? 4

(d) Company having turnover above ₹ 100 crore undertakes works contracts for pipe line execution for Drinking, Sewerage and Irrigation purpose. The required pipes for the projects, falling under Chapter 68 of CETA, are manufactured by the Company itself. A part of the production is also sold outside. Whether Cost Audit is applicable for pipe manufacture. 3

Answer:

3. (a) The Companies (Cost Accounting Records) Rules 2011 [CARR] is now applicable to all companies engaged in production, processing, manufacturing & mining. Hence, product-wise/ activity-wise cost of production and cost of sales would be available from the Cost Accounting Records of all the products/ activities, irrespective of whether these are covered under cost audit or not.

It may further be noted that in such a situation, the company would also be required to file a compliance report and for this purpose, product-wise/ activity-wise cost of production and cost of sales would be determined to prepare the reconciliation statement as required in the compliance report.

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

1. The basis of distribution of Cost of Utility to the consuming centres.
2. The cost of purchase, production, distribution, marketing and price with reference to sales to outside parties.
3. Where cost of utilities is disclosed at standard cost, the price and usage variances.
4. The cost and price of Utility received from/supplied to related parties.
5. The cost and price of Utility received from/supplied as inter unit transfers and inter company transfers
6. Cost of utilities incurred in foreign exchange.
7. Any Subsidy/Grant/Incentive and any such payment reduced from Cost of utilities.
8. Credits/recoveries relating to the Cost of utilities.
9. Any abnormal cost excluded from Cost of utilities.
10. Penalties and damages paid etc excluded from cost of utilities.

Further any change in the cost accounting principles and methods applied for the measurement and assignment of the Cost of utilities during the period covered by the cost statement which has a material effect on the Cost of utilities. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.

Disclosures shall be made only where material, significant and quantifiable.

Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.

(c) MCA General Circular No. 67/2011 dated 30th November 2011, which states that the Companies (Cost Accounting Records) Rules, 2011 are not applicable to:

(i) Wholesale or retail trading activities,

(ii) Banking, financial, leasing, investment, insurance, education, healthcare, tourism, travel, hospitality, recreation, transport services, business/professional consultancy, IT & IT enabled services, research & development, postal/courier services, etc. unless any of these have been specifically covered under any other Cost Accounting Records Rules.

(iii) Companies engaged in rendering job work operations or contracting/ sub-contracting activities, and are paid only the job work or conversion charges, such as tailoring, baking, repairing, painting, printing, constructing, servicing, etc.

(iv) Companies engaged in the production, processing, manufacturing or mining activities till such time they commences their commercial operations.

(v) Ancillary products/activities of companies incidental to their main operations *(i.e.* products/activities that do not constitute their main line of business) and wherein the total turnover from the sale of each such ancillary products/activities do not exceed *2%* of *the* total turnover of the company or ₹20 crores, whichever is lower.

However, required details of all such ancillary products/activities may be maintained under a miscellaneous group and disclosed appropriately.

(d) Applicability of cost audit is based on turnover of the total company. Any activity of a company, irrespective of the turnover of the particular activity, would be covered under cost audit if that particular activity is one of the activities listed in the cost audit order Nos. 52/26/CAB-2010 dated 2nd May 2011 or 30th June 2011.
Whether the company under reference will attract cost audit for its pipe manufacturing activity will now depend on whether the captive consumption is made for a product which is under cost audit. In this case it is not so and the pipe manufacturing will attract cost audit under this test.
However, if the production of pipes is an ancillary activity as defined in MCA General Circular No. 67/201 1 dated 30th November 2011, then pipe manufacturing would be outside purview of cost audit.

4. (a) What review should be made by a Cost Auditor of Cost Accounting Records? 7

(b) The profit as per financial accounts of M/s Kalingpong Himalaya Private Company for the year 2012-2013 was ₹ 1,54,28,642/-. The profit as per Cost Accounting Records for the same period was less. You are required to prepare a reconciliation statement and arrive at the profit as per Cost Records. The following details are collected from the financial schedules and cost accounting records: 8

	Financial Accounts	Cost Accounts
Valuation of Stock		
Opening: WIP	**25,62,315**	**22,65,710**
Finished Goods	**2,65,47,520**	**2,92,18,950**
Closing : WIP	**42,75,640**	**37,36,346**
Finished Goods	**3,72,59,430**	**4,35,25,149**

Interest income from inter-corporate deposits	**6,15,340**	**—**
Donations given	**4,85,560**	**—**
Loss on Sale of Fixed Assets	**1,22,546**	**—**
Value of cement taken for own consumption	**3,82,960**	**3,65,426**
Cost of Power drawn from own Wind Mill		
—At EB tariff	**—**	**49,56,325**
—At cost	**36,20,370**	**—**
Non-operating income	**45,36,770.**	**—**
Voluntary retirement compensation	**16,76,540**	**—**
Insurance claim relating to previous year received during the year	**14,35,620**	**—**

Answer:

4. **(a)** The cost auditor during the course of audit will thoroughly review the cost accounting records as follows:

1) Method of costing in use - Batch, Job, Process etc.
2) System of fixation of cost centres.
3) Procedures for accounting of materials and spares etc.
4) Methods of accounting of wastes, rejections and defectives.
5) System of recording of wages, salaries and overtime and their allocation.
6) Incentive schemes in vogue.
7) Basis of allocation/apportionment of utilities.
8) Method of accounting of depreciation and charging depreciation to cost centres.
9) Method of apportionment of Service Department expenses to production departments.
10) Basis of absorption of overheads to products.
11) Basis of absorption of interest, bonus, gratuity and selling and distribution overheads.
12) Budgetary Control System.
13) Internal Audit System.
14) Method of accounting of Production and Sales.
15) Treatment of research and development expenses.

(b) Working:

Computation in difference in Valuation of Stock

	Financial Accounts	Cost Accounts
Opening (WIP & FG)	2,91,09,835	3,14,84,660
Closing (WIP & FG)	4,15,35,070	4,72,61,495
	1,24,25,235	1,57,76,835

Reconciliation of Financial Profit and Costing Profit

	₹	₹
Profit as per Financial Accounts		1,54,28,642
Add: Difference in Stock Valuation	33,51,600	
Loss on Sale of Fixed Assets	1,22,546	
Donation not considered in Cost Records	4,85,560	
Voluntary retirement compensation not included in cost	16,76,540	56,36,246
Less: Non-operating income	45,36,770	2,10,64,888
Less: Interest income from intercorporate deposit	6,15,340	

Difference in value of cement taken for own consumption	17,534	
Difference in valuation of windmill power (₹ 49,56,325 – 36,20,370)	13,35,955	
Insurance claim relating to previous year	14,35,620	79,41,219
Profit as per Cost Accounts		1,31,23,669

5. (a) Trial Balance extract of M/s Rashid Ltd. as on 31.03.2013 is given below:

Particulars	**Amount (₹)**	**Particulars**	**Amount (₹)**
Materials Consumed	**32,00,000**	**Special subsidy received from Govt. towards employees Salary**	**2,80,000**
Salaries	**18,00,000**		
Employees training cost	**1,80,000**	**Recoverable amount from employees out of perquisites extended**	**30,000**
Perquisites to employees	**4,50,000**		
Contribution to Gratuity Fund	**4,10,000**		
Festival Bonus	**65,000**		
Lease rental for accommodation	**3,00,000**		
Unamortised amount of employee cost related to a discontinued operation	**80,000**		

Compute employees cost.

(b) Explain how Installed Capacity, Practical Capacity and Normal Capacity are calculated as per CAS-2 of a manufacturing concern. 3+2+3=8

Answer:

5. (a)

Computation of Employees Cost.

Particulars		Amount (₹)
Salaries		18,00,000
Add: Perquisite to employees	4,50,000	
Less: Recoverable from Employees	30,000	
		4,20,000
Add: Lease rent Provided to Employees		3,00,000
Add: Festival Bonus		65,000
Add: Contribution to Gratuity Fund		4,10,000
		29,95,000
Less: Subsidy received from Government towards Employees Cost		2,80,000
		27,15,000

(b) Calculation of Installed capacity practical capacity and normal capacity as per CAS-2 is based on :

A. Installed Capacity
   i) Manufacturers' Technical specifications
   ii) Capacities of individual or interrelated production centers.
   iii) Operational constraints / capacity of critical machines
   iv) Number of shifts
   v) Any other factor
      (i) In case of manufacturers' technical specifications are not available, the estimates by technical experts on capacity under ideal conditions may be

considered for determination of installed capacity.
(ii) In case a product passes through different production processes and each process is having different capacity then the process which brings effective or ultimate production shall be considered for deciding installed capacity.

B. Practical Capacity
Practical capacity is determined after adjustment of the following with the installed capacity.
(i) Available production hours taking into consideration holidays, normal shut down days and normal idle time.
(ii) Normal time loss in batch change over, break downs of machines, repairs etc.
(iii) Loss in efficiency due to ageing of the machines/equipment
(iv) Number of shifts
(v) Any other factor

C. Normal Capacity
Normal Capacity is determined by following method
1. Normal capacity is determined based on the productive capacity achieved over a period of time, say average of three normal years out of preceding five years or expected to be achieved over a period of time, say next three to five years .
2. This capacity is determined after adjustment of external factors with practical capacity.
3. Normal capacity of production process involved in the production of a product or the productive capacity of the plant as a whole should be taken into account to arrive at normal capacity for a product or plant, as the case may be.
4. The periods influenced by abnormalities should be excluded for this purpose.
Explanation:
1. In case the same products with different specifications and of different ranges in terms of size, type, variety etc. are manufactured, then there is a need to determine equivalence among them in order to determine the capacity.
2. In case some intermediate products / components etc are also produced, they should be taken into consideration for determining equivalent capacity.
3. In case some machines are leased out/let out or some machines are taken on lease, resulting decrease / increase in capacity should also be considered.

SECTION B (20 Marks)
Answer any two Questions.

10x2=20

6. (a) How the adequacy of Internal Audit function can be assessed? 5
(b) What is the role of Audit Committee, where applicable, in dealing with the Cost Audit Report? Can the Cost Audit Report and Annexure be approved by the Audit Committee and/or Board of Directors by circular resolution? 5

Answer:

6. (a) Many a times it is required to assess the adequacy of internal audit function of an organization to assess the reliability of Internal audit. The following questionnaire may be required to evaluate the work of the internal auditor and assess the adequacy of the internal audit function:
1. What is the organizational set up of the department?
2. Is the staff employed in the department adequate?

3. Are the qualifications of the staff adequate
4. Is the staff competent?
5. Is the staff independent?
6. To whom do they report frequently and with what effect?
7. Is there any internal audit manual?
8. Is a programmed of internal audit drawn up before the commencement of the financial year?
9. Does the programmed cover the audit of all the important transactions and records of the company including statutory cost accounting records?
10. Is the scope of internal audit wide enough to extend to areas such as, management audit, operational audit and system analysis?
11. What is the system of reporting irregularities noticed during internal audit?
12. Is prompt corrective action taken by the management on the basis of internal audit reports?
13. Is there much duplication of work between the statutory audit and internal audit?

(b) MCA Master Circular No. 2/2011 dated 11th November 2011 States as follows-.

1. Section 292A(6) of the Companies Act, 1956 states that the Audit Committee should have discussions with -the auditors periodically about internal control systems, the scope of audit including the observations of the auditors and review the half yearly and annual financial statements before submission to the Board and also ensure compliance on internal control systems.
2. Departmental Circular No. 6/2001 dated 20.08.2001 has clarified that the term "auditors" includes cost auditor and hence "scope of audit including observations of the auditors" occurring in the above sub-section includes the scope of cost audit including observations of the cost auditors as well.
3. The presence of the cost auditor in such committees will ensure overall cost management, efficiency in resource utilization, business vertical-wise performance evaluation, proper pricing of inter-unit/inter-company transfers and valuation of inventories. Hence, the company must place the cost audit report before the Audit Committee first, which in its duty to ensure compliance of internal control system shall also discuss the suggestions made in the cost audit report for implementation, wherever cost audit has been directed under section 233B of the Companies Act, 1956.

The Audit Committee, after due consideration of the Cost Audit Report is required to submit the same for approval of the Board of Directors. Since the Board of Directors is required to approve the Annexure to the Cost Audit Report and authorize one of the Directors and the Company Secretary (two Directors in the absence of a Company Secretary) to sign the same, the Board should also consider the Cost Audit Report in a duly convened meeting and it would not be advisable to approve the same by circular resolution.

7. (a) What is the objective of purchase management? What are the main points to be taken into account while preparing a set of questionnaire to evaluate purchase management function? 6

(b) What are the characteristics of ERP system and what are the requirements for Audit approach? 2+2=4

Answer:

7. (a) The primary objective of purchase management is to procure raw materials, packing material etc of the requisite quantity of required quality at reasonable cost at the right time. A management accountant may make a model questionnaire for evaluation of purchase management:-

(a) What is the organization for purchase function?

(b) Whether the purchase policy is realistic?
(c) Whether the purchase requirements are related to production schedules and dependent upon the level of invention?
(d) How are suppliers selected and eliminated?
(e) Whether regular and dependable suppliers are ensured?
(f) Is there any system of purchase authorization?
(g) Whether latest market information automatically collected regarding new spares, etc.
(h) Whether proper information is kept about price trends?
(i) Whether regular comparison is made between average price paid and the corresponding average market price?
(j) What are built-in-controls against misutilisation of purchasing powers?
(k) How effective is the system of follow-up?
(1) What is the system of executing emergency purchase?
(m) What is the procedure followed for impact of raw materials?
(n) Is there any proper coordination between purchase, stores and production?

(b)

An ERP system is not only the integration of various organization processes, any system has to possess few key characteristics to qualify for a true ERP solution. Some of them are:

- Flexibility
- Modular and Open
- Comprehensive
- Beyond the Company
- Best business practices
- New technologies

The major characteristics of ERP systems necessitating change in the Audit approach are as follows:
(i) On-line real time processing
(ii) All transactions are stored in one common database but usually reside on multiple computers.
(iii) Significant increase in number of users' therefore optimum co ordination is a challenge
(iv) System modules are transparent to all the users
(v) Data bases can be accessed by any module
(vi) Traditional 'batch' controls and audit trails not available
(vii) Network and data base access security is critical.

The audit under ERP system requires in depth knowledge and an understanding of the integrated complex system. The auditors require not only specialized skills but also capability to use unique methodologies to deal with various risks involved in Audit and review guidelines should also be developed providing management oriented frame work and proactive control self assessment.

8. (a) A Company engaged in manufacturing of chemicals is consistently recording higher sales turnover, but the net profits is showing a declining trend since the last 5 years. As a Management Auditor appointed to find out the reasons for the same, mention the points you would investigate. 5

(b) "Management Audit and Operational Audit are complementary and supplementary to one another". Discuss in brief. 5

Answer:

8. (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:

1 Unfavorable Sales mix
2 Negative Impact of Financial Leverage - Higher Debt and Interest would result in lower profit.
3 Other items included in Sales - Where the amount of Exercise Duty goes up considerably the total sales may show an increase which is not represented by a real increase in quantity/value.
4 High Administrative and Selling Expenses - 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.
5 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 declining trend in short run.
6 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) 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.

SECTION C (20 Marks)
Answer any two Questions.

10x2=20

9. (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:

(₹ In lakhs)

	31.03.2013	31.3.2012	31.03.2011
Gross sales inclusive of Excise Duty	2,040	1,985	1,875
Excise Duty	295	280	265
Raw Materials consumed	1,140	1,060	975
Direct Wages	35	32	27
Power and Fuel	30	27	24
Stores and Spares	6	5	4
Depreciation charged to production cost centres	16	15	13
Factory overheads:			
Salaries and wages	5	4	3
Depreciation	2	2	2
Rates and Taxes	1	1	1
Other overheads	6	5	4
Administrative overheads:			
Salaries and Wages	10	9	8
Rates and Taxes	2	2	2
Other overheads	162	154	148
Selling and distribution overheads:			
Salaries and Wages	7	6	5
Packing and Forwarding	6	6	5
Depreciation	1	1	1
Other overheads	124	118	108
Interest	85	74	68
Bonus and Gratuity	12	10	9
Gross Current Assets	840	724	640
Current Liabilities and Provisions	324	305	246

You are required to compute the following ratios as per requirement of Para 9 in the Cost Audit Report Rules 2011 for 3 years:
(i) Operating Profit as percentage of Value Addition.
(ii) Value Addition as percentage of Net Sales. **5+5=10**

Note: The computation should be based on EBDIT as Operating Profit.

Answer:

9.

	Year Ending (₹ In lakhs)		
	31.3.13	**31.3.12**	**31.3.11**
Gross sales inclusive of Excise Duty	2,040	1,985	1,875
Excise Duty	295	280	265
Net sales (A)	1,745	1,705	1,610
Cost of Sales excluding depreciation & Interest			
Raw Material consumed	1,140	1,060	975
Direct Wages	35	32	27
Power and Fuel	30	27	24
Stores and Spares	6	5	4
Factory overheads (excluding depreciation)	12	10	8

Administrative overheads (excluding depreciation)	174	165	158
Selling and distribution overheads (excluding depreciation)	137	130	118
Bonus and Gratuity	12	10	9
Total (B)	1,546	1,439	1,323
Operating Profit (A) - (B) =	199	266	287

Value addition is defined in Para 8 of the Cost Audit (Report) Rules, 2011 as "the difference between the net output value (Net Sales) and cost of bought out materials and services for the product under reference".

The working will be :

	Year Ending		
	31.3.13	**31.3.12**	**31.3.11**
(X) Net sales	1,745	1,705	1,610
Less : (i) Cost of Bought Out Materials & Service (Raw Materials and Stores & Spares)	1,146	1,065	979
(ii) Power & Fuel, other bought out services	30	27	24
(iii) Over heads (excluding Salaries & Wages, Rates & Taxes and depreciation)	298	283	265
(Y) =(i)+(ii)+(iii)	1,474	1,375	1,268
Value Addition : (X) - (Y) =	271	330	342

	Year Ending		
	31.3.13	**31.3.12**	**31.3.11**
Hence, (a) Operating profit as % of Value Added i.e.	199/271 73.43%	266/330 80.6%	287/342 83.92% =84%
(b) Value Addition as % of Net Sales i.e.	271/1745 15.53%	330/1705 19.35%	342/1610 21.24%

10. (a) The following data have been available of Sunflag Dolon Limited:

	2010 - 11	**2011 - 12**	**2012 - 13**
Installed Capacity—Ton	**250**	**250**	**250**
Production—Ton	**240**	**230**	**125**
Cost Per Ton (₹)	**1,000**	**1,077**	**1,660**

The poor capacity utilisation in 2012-13 was due to abnormal power-cut. The escalation in costs were 5% in 2011-12 and 7% in 2012-13 base on 2010-11

(i) Calculate the abnormal cost due to power cut.

(ii) How would you treat these abnormal cost? 7

(b) Following figures are available for Good Luck Ltd.:

Budgeted Production-880 units, Standard Hours per unit-10,

Actual Production-750 units and Actual working hours-6000

Calculate (i) Efficiency ratio (ii) Activity ratio and (iii) Capacity ratio 3

Answer:

10. (a)

	2010-11	2011-12	2012-13
Installed Capacity - Ton	250	250	250
Production - Ton	240	230	125
% of Capacity Utilisation	96	92	50
Cost per Unit (₹/Ton)	1,000	1,077	1,660
Escalation factor	100	105	107
Cost at base year price	1,000	1,026	1,551
Total cost of production (₹)	2,40,000	2,35,980	1,93,875
Variable Cost/Ton (₹)	402	402	402
Fixed Cost/Ton	598	624	1,149
Fixed Cost @ 100% utilisation(₹)	574		

Hence, increase in Fixed Cost/Ton due to poor capacity utilization in 2012-13 =(1,149-574)=₹ 575

i) Total abnormal cost due to power cut = 575 x 125 = ₹ 71,875

ii) The abnormal cost must be excluded from computation of cost and has to be shown under Para 7 of the Cost Audit Report as "Abnormal Non-Recurring Cost".

iii) The 50 % under utilisation of capacity being due to power-cut only, the Company should consider possibility of captive generation, if the power-cut is likely to persist. Accordingly, the investment needed, potential savings, etc. must be computed to determine the viability of such a decision.

Working:

	2011-12	2012-13
Difference in Total Cost	4,020	46,125
Difference in production	10	105
Hence Variable Cost	**402**	**402**

(b)

Efficiency Ratio:

$$= \frac{\text{Standard Hours of actual production}}{\text{Actual hours worked}} \times 100$$

$$= \frac{750 \text{ units} \times 10 \text{ hours}}{6000} \times 100$$

$$= 125\%$$

Activity Ratio:

$$= \frac{\text{Standard Hours for actual production}}{\text{Budgeted Hours}} \times 100$$

$$= \frac{750 \text{ units} \times 10 \text{ hours}}{880 \text{ units} \times 10 \text{ hours}} \times 100$$

$$= 85.23\%$$

Capacity Ratio:

$$= \frac{\text{Actual Hours worked}}{\text{Budgeted Hours}} \times 100$$

$$= \frac{6000 \text{ hours}}{880 \text{ units} \times 10 \text{ hours}} \times 100$$

$= 68.18\%$

11. The following is the Balance Sheet of Jamuna Sing Ltd. of Chandigarh as on 31st December, 2013 and 31st December, 2012:

	31.03.13	31.03.12
Non Current Assets		
Fixed Assets - Tangible Assets	4,20,000	4,45,000
Non Current Investments	55,000	30,000
Long Term Loans and Advances	40,000	85,000
Current Assets		
Stock in trade	2,30,000	1,50,000
Sundry Debtors	1,60,000	1,50,000
Bills Receivable	35,000	20,000
Advance Payment to contractors	10,000.	3,000
Cash and Bank	25,000	15,000
	9,75,000	8,98,000
Equity and Liabilities		
Shareholders' Fund	3,80,000	3,80,000
Reserves and Surplus	2,75,000	2,20,000
Non Current Liabilities		
Long term Borrowings	50,000	50,000
Deferred Tax	20,000	20,000
Current Liabilities		
Sundry Creditors	1,90,000	1,80,000
Bills Payable	60,000	48,000
	9,75,000	8,98,000

You are required to prepare a schedule showing the followings:

(i) Change in Working Capital

(ii) Liquidity and proprietory ratios for the two years. **10**

Answer:

11. (i) Schedule of changes in Working Capital:

	31.03.12	31.03.13	Increase	Decrease
Current Assets				
Stock in trade	1,50,000	2,30,000	80,000	
Sundry Debtors	1,50,000	1,60,000	10,000	
Bills Receivable	20,000	35,000	15,000	
Advance Payment to contractors	3,000	10,000	7,000	
Cash and Bank	15,000	25,000	10,000	
	3,38,000	4,60,000		
Current Liabilities				
Sundry Creditors	1,80,000	1,90,000		10,000
Bills Payable	48,000	60,000		12,000
	2,28,000	2,50,000		
Net working capital	1,10,000	2,10,000	1,22,000	22,000
Increase	1,00,000			1,00,000
	2,10,000	2,10,000	1,22,000	1,22,000

(ii) Liquidity Ratios:

(a)	Current Ratio	31.03.2013 = 338000/228000 31.03.2012 = 460000/250000	= 1.48 = 1.84
(b)	Acid Test Ratio	31.03.2013 = 188000/228000 31.03.2012 = 230000/250000	= 0.82 = 0.92
(c)	Proprietary Ratio	31.03.2013 = 655000/975000 31.03.2012 = 600000/898000	= 0.67 = 0.67