FINAL EXAMINATION

GROUP IV

(SYLLABUS 2012)

SUGGESTED ANSWERS TO QUESTIONS

DECEMBER 2015

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.

This paper contains 3 questions, representing three separate sections.

All three questions are compulsory, subject to the specific instructions provided against each question.

All workings wherever necessary, must form a part of your answer.

Assumptions, if any, should be clearly stated.

Please : (1) Answer all bits of a question at one place.
(2) Open a new page for answer to a new question.

SECTION A (60 marks)

1. Answer the *four* questions. (carrying 12 marks each):

(a) (i) The following details are extracted from the Cost Accounting Records of DIVYAN LTD.

	Amount in ₹
Purchase price of Materials (inclusive of Trade Discount ₹ 4,000)	5,00,000
Import duty paid	45,000
fee on Board	10,000
Insurance paid for import by sea	15,000
Rebates allowed	5,000
Freight Inward	20,000
Cash discount	4,000
CENVAT refundable	7,000
Subsidy received from the Government for imporation of Materials	18,000
Abnormal loss of Material	14,000

Required:
Compute the Landed Cost of Materials (Value of Receipt of Materials) **5**

(ii) SUNFLAG SUGAR MILLS LTD. located at Maharashtra has a boiler used for its own by-product, Baggasse as fuel for generating steam. The high pressure 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 Company for the year ended 31st March, 2015.

	Boiler	Steam Turbine
High pressure steam Generated	**34780 M.T.**	
Power generated		**2540000 KWH**
Cost	**₹**	**₹**
Water	**10,48,170**	**---**
Fuel (Baggasse)	**9,21,43,460**	**---**
Stores and Chemicals	**2,57,070**	**65,695**
Salaries and Wages	**29,58,250**	**7,32,900**
Repair and Maintenance	**65,64,200**	**2,57,700**
Depreciation	**17,24,700**	**6,49,600**
Other Expenses	**39,93,600**	**1,20,700**

Note: To Calculate Cost of Power generated, credit for exhaust steam to be taken as 80% of Cost of steam.
You are required to prepare two separate cost sheets for steam and power as per the companies (Cost Records and Audit) Rules 2014 for the year ended 31st March, 2015.

3+4=7

Answer:

1. (a) (i) Computation of (Landed) Cost of Materials

Particulars		**Amount (₹)**
Purchase of materials		5,00,000
Add:		
Fee on Board		10,000
Import Duties on purchasing the materials		45,000
Freight inward during the procurement of materials		20,000
Insurance paid for import		15,000
Total		5,90,000
Less:		
Rebate allowed	5,000	
Trade discount	4,000	
Cenvat credit refundable	7,000	
Subsidy received from Govt., for importation of materials	18,000	
Abnormal loss of materials	14,000	48,000
Value of Receipt of materials		**5,42,000**

Note: Cash discount is not allowed as it is a financial item.

(ii)

Sunflag Sugar Mills Ltd.

(1)

Cost sheet of steam for the year ended March 31. 2015.

Cost of steam **Steam generated: 34780 MT**

Particulars	**Total amount ₹**	**Cost/MT of Steam (₹)**
Water	10,48,170	30.14
Fuel (Baggasse)	9,21,43,460	2,649.32

Stores and chemicals	2,57,070	7.39
Salaries and wages	29,58,250	85.06
Repairs and maintenance	65,64,200	188.74
Depreciation	17,24,700	49.59
Other expenses	39,93,600	114.82
	10,86,89,450	3,125.06

(2)

Cost sheet of power (generated) for the year ended March 31, 2015

Cost of Power generated by steam turbine. Power generated: 2540000 KWH

Particulars	Total amount ₹	Cost/KWH(₹)
Steam	10,86,89,450	42.79
Stores and chemicals	65,695	0.03
Salaries and wages	7,32,900	0.29
Repairs and maintenance	2,57,700	0.10
Depreciation	6,49,600	0.25
Other expenses	1,20,700	0.05
	11,05,16,045	43.51
Less: Credit for exhaust steam	8,69,51,560	34.23
Total cost of Power	2,35,64,485	9.28

Working: Value of exhaust steam at 80% of steam: 80% of ₹ 10,86,89,450 = ₹ 8,69,51,560

1. **(b) (i) What are the duties of the companies in relation to provisions of section 148 of the Companies Act 2013 and Rules framed thereunder? 4**

(ii) PRANTIKA LTD., a manufacturing company provides the following extracts from its records for the year ended March 31, 2015.

The Company's specifications—Capacity for the machines per hour	**1800 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) Practical Capacity
(3) Actual Capacity
(4) Normal Capacity
(5) Idle Capacity
(6) Abnormal Idle Capacity—Keeping in view of the relevant Cost Accounting Standard (CAS-2). 1+2+1+2+1+1=8

Answer:

1. (b) (i) 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 Govt. 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 Companies (Registration offices and Fees) Rules, 2014.

(ii)

PRANTIKA LTD.

CALCULATION OF DIFFERENT CAPACITIES for the machines:

1.	Installed Capacity	365×8×3×1800=157.68 lakh units
2.	Practical Capacity	(365-52-13)×(8-1)×3×1800 = 300×7×3×1800 = 113.40 lakh units
3.	Actual Capacity Utilization	[(97.80)÷157.68] × 100 = 62.02%
4.	Normal Capacity	(104.90 + 93.56 + 91.30)/3 = 96.59 lakh unit
5.	Idle Capacity	(157.68 – 97.80) = 59.88 lakh units (59.88)÷157.68 = 0.3798 = 0.3798 i.e. 37.98%
6.	Abnormal idle capacity	(113.40 – 97.80) = 15.60 lakh units i.e., or (15.60/113.40) = 13.76%

1. (c) (i) MENZ (IND) LTD., a manufacturing Company is engaged in manufacturing of multiple products. Some of the products are covered under the Companies (Cost Records and Audit) Rules, 2014 and some are not. Part-A, Para 4 of the Annexure to the Cost Audit Report (product/Service Details for the company as a whole) requires Net Operational Revenue to be reported for each CETA Heading for both the current year and the previous year.

Can the Net Operational Revenue of all the Products that are not covered under the Rules be reported in this Para as a single line item? 5

(ii) The Companies Act, 2013 has introduced provision regarding rotation of Auditors. Is the provision of rotation of Auditors applicable to Cost Auditors also? 5

(iii) Revised FORM CRA-2 has been made available by the Ministry of Corporate Affairs conforming to the Companies (Cost Records and Audit) Rules, 2014 on 31st December, 2014.

What are the required attachments to FORM CRA-2? 2

Answer:

1. (c) (i) Part-A, Para 4 of the Annexure to the Cost Audit Report of the 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. Hence, the company would be required to report Net Revenue of every CETA Heading irrespective of whether the same is covered under maintenance of cost accounting records and cost audit or not. In case some of the Products are under the same CETA Heading but having different units of measurement (UOM), then Net Revenue is to be reported for separate UOMs. It may be noted that the number of quantitative details 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.

If the company is engaged in manufacturing of products as well as providing of services and/or trading, such services which are covered under the Companies (Cost Records and Audit) Rules, 2014 will be required to be reported separately according to the definition provided in the Rules classified under different types of services within the same class of service. It may be noted that the number of quantitative details and abridged cost statements will have to be provided for each classification of service covered under cost audit.

Other services that are not covered under the Rules and Revenue from Trading Activity may be reported under suitable heads denoting the service/activity.

The New Taxonomy has introduced a separate line item in this para to report "Other Operating Incomes" which will form part of the Total Operating Revenue.

1. (c) (ii) 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.

1. (c) (iii) Required Attachments to Form CRA-2:

The Form has provided an attachment button for attachment of certified copy of the Board Resolution appointing the cost Auditor. The consent letter of the Cost Auditor should be attached as optional attachment.

1. (d) **The following are condensed comparative financial statement of CAROLINA LTD., a single product manufacturing company for three years ended 31st March, 2015, 2014 and 2013.**

(Amount in ₹ Lakh)

Equity & Liabilities	2015	2014	2013
Shareholders' Fund:			
Equity Share Capital	3,000	2,000	2,000
Reserves and Surplus	4,360	3,250	2,440
Non-Current Liabilities:			
Term Loans	3,080	1,650	1,500
Debentures	1,600	1,600	1,600
Other Long-term Loans	1,200	1,500	1,400
Current Liabilities:			
Current Liabilities	2,660	1,252	1,720
Short term Provisions	800	600	500
Total	16,700	11,852	11,160
Assets			
Non-Current Assets:			
Fixed Assets:			
Tangible Assets	4,066	3,808	3,600
Intangible Assets	---	---	---
Capital Work in Progress	1,704	---	---
Non-Current Investments:			
Investment in subsidiaries	800	400	400
Current Assets:			
Inventories	4,030	2,490	2,320
Trade Receivables	4,810	3300	3,040
Cash and Cash equivalents	610	404	760
Short term Loans and Advances	680	1,450	1,040
Total	16,700	11,852	11,160

Profit and Loss Account for the year ended March 31.	2015	2014
	(Amount in ₹ Lakh)	
Income:		
Revenue (including excise duty) from Operations	29,040	24,510
Expenditure:		
Material consumed	11,340	9,008
Excise duty on despatches	6,690	6,852
Employee Costs	1,650	1,380
Other Manufacturing expenses	1,100	960
Selling and distribution expenses	3,102	2,802
Administration expenses	500	460
Interest on:		
Term Loans	692	402
Debentures	240	240
Other long term loans	160	200
Depreciation	604	400
Difference in Stock	1,652	536
	27,730	23,240

Profit before Taxation (PBT)	**1,310**	**1,270**
Provisions for Taxation	**200**	**460**
Profit After Taxation (PAT) (Transferred to Balance Sheet)	**1,110**	**810**

You are required to compute the following values of (i), (ii), (iii) and ratios as stipulated in PART-D, PARA-4 to the Annexure of Cost Audit Report under the Companies (Cost Records and Audit) Rules, 2014 for the year ended March 31, 2014 and 2015 respectively.

(i) Capital Employed
(ii) Net Worth
(iii) Net Revenue from Operations
(iv) PBT to Capital Employed
(v) PBT to Net Worth
(vi) PBT to Net Revenue from Operations
(vii) Debt-Equity Ratio **3+2+2+l+(1×4)=12**

Answer:

1. (d)

CAROLINA LTD.

(Amount in ₹ Lakh)

i) CAPITAL EMPLOYED: Year ended March 31	2015	2014	2015	2014	2013
Total Assets			16,700	11,852	11,160
Less: Investment in Subsidiaries			800	400	400
Less: Current liabilities			3,460	1,852	2,220
Less: Capital work in progress			1,704	-	-
			10,736	9,600	8,540
Average capital employed for the year ended March 31 (10,736+9,600)/2, (9,600+8,540)/2			**10,168**	**9,070**	
ii) NET WORTH: Share capital	3,000	2,000			
Reserves and surplus	4,360	3,250	7,360	5,250	
iii) NET REVENUE from Operations: Revenue (including excise duty) from operations	29,040	24,510	22,350	17,658	
Less: Excise Duty	6,690	6,852			
Profit before Tax (PBT)			1,310	1,270	
Working note:					
Current Liabilities:					
Current liabilities	2,660	1,252			
Short term provisions	800	600	3,460	1,852	
Debt:					
Term loans	3,080	1,650			
Debentures	1,600	1,600			
Other long term loans	1,200	1,500	5,880	4,750	
			2015	2014	
iv) PBT to Capital Employed	1310/10168	1270/9070	12.88%	14%	
v) PBT to net worth	1310/7360	1270/5250	17.80%	24.19%	
vi) PBT to net revenue from Operations	1310/22350	1270/17658	5.86%	7.19%	
vii) Debt equity ratio	5880/7360	4750/5250	0.8:1	0.9:1	

1. (e) (i) What are the matters that are relevant in formulating Audit Strategy and drawing up the Audit Plan? 5

(ii) Whether a Cost Auditor can be appointed as Internal Auditor of the Company? Whether there is any restriction on the Cost Auditor to accept assignments from a company where he is the Cost Auditor? 3

(iii) What disclosures are required to be made in Cost Statement as per CAS-19 as regard to JOINT COSTS? 4

Answer:

1. (e) (i) As per cost auditing standard-101, matters that are relevant in formulating the overall audit strategy and drawing up the audit plan include, in addition to those mentioned earlier, the following: (a) The cost reporting framework generally prescribed, under the Companies Act, and Rules prescribed thereunder, as well as under any other law as applicable, on the basis of which the cost information to be audited has been prepared, including need for reconciliation with financial reporting framework, (b) industry regulators' requirements as to how costs will be handled, (c) Unique features of an industry that influence audit requirements such as definition of product in the newspaper industry, (d) Reliance that can be placed on the work of financial auditors, other cost auditors appointed by the entity and internal auditors, such as their attendance in annual stocktaking, (e) State of IT (Information Technology) implementation, whether the entity is using an ERP (Enterprise Resource Planning) system or internally developed systems and the reliance that can be placed on them, (f) Statutory timelines for cost reporting, which can be modified by the management for early completion, (g) Timelines for Board/audit committee meetings, which can set the time limits for completion of audit work, (h) Resources required and available in terms of manpower, equipment and others and the assignment of these to specific parts of the work.

1. (e) (ii) A cost auditor cannot render any services to the company whether acting individually, or through the same firm or through other group firms where he or any partner has any common interest, relating to:

(i) Design and implementation of cost accounting system; or
(ii) The maintenance of cost accounting record; or
(iii) Act as internal auditor,

However, a cost auditor can provide any other services as may be assigned by the company, excluding the services mentioned above.

1. (e) (iii) The following disclosures are required to be made in the cost statement as per CAS-19 as regard to Joint Costs:

(1) The cost statement shall disclose the basis of allocation of Joint costs to individual products and the value assigned to the by-products.
(2) The cost statement shall also disclose
(3) The disclosure should be made only where material, significant and quantifiable.
(4) Disclosures shall be made in the body of cost statements or as a foot note or as a separate schedule.
(5) Any change in the cost accounting principles and methods applied for the measurement and assignment of the Joint costs and the value assigned to by-product during the period covered by the cost statement which has a material effect on the joint/by-products shall be disclosed. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.

1. (f) (i) A textile composite mills in the course of modernization issued voluntary retirement notice for 50 workers and the package cost ₹ 144.80 lakhs. This would amount to savings in wages of ₹ 260 lakhs over a period of 5 years. The package included closing down the Weaving Department.
How would you treat separation cost due to voluntary retirement as per CAS-7 related to Employee Cost? 2

(ii) A company acquired a Diesel Generating Set (500 KVA) to cater the shortfall of power supply from the grid. The DG Set was on lease and the annual payout was ₹ 1,25,000 toe the leasing company.
How the cost will be treated in the cost accounts?
Will the company required to maintain records for captive power generation? 3

(iii) "The Cost Audit report contains significant information which would help to assess and improve operational efficiency of a concern:
Discuss the statement with reference to the matters to be reported by a Cost Auditor in his report. 7

Answer:

1. (f) (i) Cost Accounting Standards-7 (Para-5.4) deals with separation costs of employees due to some restructuring in the organization. The separation costs related to voluntary retirement, retrenchment termination etc shall be amortized over the period benefitting from such costs. The amortized separation costs for the period shall be treated as indirect cost and assigned to cost objects in an appropriate manner. However, unamortized amount related to discontinued operations shall not be treated as employee cost.

1. (f) (ii) Cost Accounting Standards 11 issued by the Institute of Cost Accountants of India deals with Administrative Overheads. In case of Financial lease, the element of finance cost in the lease rental should be segregated and shown as Finance Costs under Administrative Overhead'. In case of Operating Lease, the entire lease rental should be included in Administrative Overhead.

In case of a company whose product(s)/service (s) are covered under the Rules and it consumes electricity from the captive generating plant, determination of cost of generation, transmission, distribution and supply of electricity as per CRA-1 would be mandatory since the cost of consumption of electricity has to be at cost. Hence, maintenance of cost records for generation, transmission, distribution and supply of electricity would be applicable. However, cost audit will not be applicable to such captive plants, provided the entire generation is consumed captively and no portion is sold outside.

1. (f) (iii) (I) The Cost Auditor has to report whether the Cost Accounting System followed is adequate for determination of the fair cost of production.

(II) He has to report on the financial performance of the company as well as of the product under cost audit, along with various ratios and offer comments on the ratios.

(III) He has to indicate the percentage of production in relation to the installed capacity expressed in appropriate units of measurement. He has also to state reasons for the shortfall in production bringing out clearly the extent to which they are controllable both in short term as well as long term.

(IV) He has to give observations as regards variations, if any, in the rate of major raw materials, power and fuel etc. in terms of rate per unit as compared to previous year, if any.
(V) He has to give details of wages and salaries including direct labour cost per unit of output and as compared to the previous year.
(VI) He has to indicate the amount of overheads along with reasons for any significant variations in expenditure incurred against the items of factory, administration, selling and distribution overheads as compared with previous two years.
(VII) The cost auditor has also to mention any abnormal feature affecting the production indicating their effect on the unit cost of production.

Again the cost auditor may offer suggestions as regard the following matters for improvements in performance of the company under audit with reference to:-
(a) Rectification of general imbalance in production facilities
(b) Fuller utilization of installed capacity
(c) Concentration on areas offering scope for cost reduction, increased productivity and key limiting factors causing production bottlenecks; and
(d) Suggesting improved inventory policies

As far as possible data for the earlier years has to be furnished. The cost auditor could also interpret the data from the trend for the earlier years, and offer suggestions.

The opinions shall be bases on verified data, reference to which shall be made and shall be included after the company has been given an opportunity to comment on items.

SECTION B (20 marks)

2. Answer the *two* questions. (carrying 10 marks each):

(a) (i) What are the main areas of operation for Internal Audit of a company? 5

(ii) "Operational Auditing is an extension of Internal Audit in operational Areas but with different approach."
Examine this statement in the light of the objectives of Operational Audit. 5

(b) (i) What are the objectives of Management Audit? 5

(ii) What do you understand by "Corporate Image"? What are the possible approaches to evaluate Corporate Image? 1+4=5

(c) 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. 10

Answer:

2. (a) (i) Internal audit involves the following area of operations:

1. **Reliability and integrity of financial and operating information:**
Internal auditor should review the reliability and integrity of operating and financial information and means used to identify, measure, classify and report such information.

2. **Compliance with law, plans, procedures and regulations:** Internal auditor should review the systems established to ensure compliance with those policies, plan and procedure, law, regulations which have a significant impact on operations and reports and should determine whether the organization is in compliance thereof.
3. **Safeguarding of Assets:** The internal auditor should verify the existence of assets and should review the means of safeguarding assets.
4. **Economic and efficient use of resources:** Internal auditor should ensure the economic and efficient use of resources.
5. **Accomplishing of established objectives and goals and operation:**
   Internal auditor should review operation of programmes to ascertain whether the results are consistent with established objectives and goals and whether the operations or programmes are being carried out as planned.
   The scope of internal audit at first phase is related to past business and not planning decision such as, whether to make or buy, whether to undertake a new project or export etc. These are managerial decisions and the scope of internal audit is not practical in initial stage unless it is management audit. The 2nd phase is the execution stage having its base in the subsequent recording in books of accounts. In this stage the scope of internal audit is necessary which need the correction of accounts and proper classification of heads. The final phase is the review of transactions where it is mainly the scope of internal audit.

2. (a) (ii) Operational auditing is review of operational methods and procedures. To that extent it is no more than internal audit extended to operational areas. However, as applied to operational areas the attempt must be not only evaluate controls, but also assess the effectiveness of existing procedures to meet the objectives and plans of the department which is being audited.

The objectives of operational audit may be briefly listed as appraisal of the relevant departments.

- Objectives and plans
- Controls.
- Existing procedures to achieve the objectives and plans.
- Quantitative measures to monitor of performance.
- Productivity

Since operating departments would be structuring their methods and procedures based on their objectives and plans, such objectives and plans have to be appraised. Restatement or changes in definitions of the objectives could have an impact on the plans and similar change in plans may make it advisable to redefine the objectives. Hence appraisal of plans and objectives becomes essential and the first step in operational audit.

The procedure in the department have to be reviewed and appraised to assess their effectiveness in achieving the objectives and plans with the given resources.

It is necessary that every department should develop a few quantitative measures to monitor their performance. Such measures may be in simple or composite units. The trend of such measures, the usefulness of such indicators as well as their reliability may have to be appraised as part of operational auditing. Appraisal of productivity could be complex as the term 'Productivity' is all embracing and covers the effectiveness of entire operations of the concerned department.

2. (b) (i) Objectives of Management Audit:

Management audit is carried out to-

a. Appraise the management performance at all the levels.
b. Spotlight the decision or activities that are not in conformity with organizational objectives.
c. Ascertain that objectives are properly understood at all levels;
d. Ascertain that controls provided at different levels are adequate and effective in accomplishing management objectives or plans of operations;
e. Evaluate plans which are projected to meet objectives,
f. Review the company's organizational structure, i.e. assignment of duties and responsibilities and delegation of authority.

The main objectives of management audit can be summarized as follows:-

(i) To ensure optimum utilization on all the resource employed, including money, materials, machines, men and methods;
(ii) To highlight efficiencies in objectives, policies, procedures and planning;
(iii) To suggest improvement in methods of operations;
(iv) To highlight weak links in organizational structure and in internal control systems and suggest necessary improvements;
(v) To help management by providing health indicators and help prevent sickness or help cure in case of sickness; and
(vi) To anticipate problems and suggest remedies to solve them in time.

2. (b) (ii) Corporate Image:

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

- Customers measure it by the product quality, prompt and courteous after sales service, regularity in maintaining supplies etc.
- Shareholders, measure it by the consistency in financial performance and prospects of growth.
- Supplier measure it by the company's liquidity and ability to honour commitments.
- Banks and Financial Institutions measure it by the financial health, net worth and history of serving debts.
- Government looks at it from the point of view of revenue generation and as an honest tax payer.
- Employees look for steady career growth and smooth industrial relations.

Evaluation of Corporate Image

Evaluation of Corporate Image is a very complex process and it involves a critical examination of events and trends concerning business environment-both internal as well as external. The following are the steps to evaluate Corporate Image

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

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

The summary should through light on what the company has been able to do for itself and for the public in general, represented by the six group- identified earlier.

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

(i) 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?

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

(iii) 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?

(iv) 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.?

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

(vi) 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?

SECTION C (20 marks)

3. **Answer the *two* questions. (carrying 10 marks each):**

(a) **The following are the financial statements of KODIAC LTD. For the year ended March 31, 2015.**

Balance Sheet as on March 31, 2015

(Amount in ₹ Lakh)

Equity & Liabilities		Assets	
Shareholders' Fund:		Non-Current Assets:	
Equity share capital	560	Fixed Assets (Net)	2,100
Preference Share Capital	280	Goodwill	280
Reserves & Surplus:	560	Current Assets:	
Non-Current Liabilities:		Cash at bank	140
Long term debt	1,680	Trade Receivables	700
Current Liabilities:		Inventories	980
Trade Payables	840		
Outstanding Expenses	80		
Provision for tax	200		
	4,200		4,200

Profit and Loss Account for the year ended March 31, 2015

(Amount in ₹ Lakh)

Sales:		
Cash		560
Credit		2,240
		2,800
Less: Expenses:		
Cost of goods sold	1,680	
Administrative, Selling and General Expenses	280	
Depreciation	196	
Interest on Long-term debt	84	2,240
Profit before Taxes		560
Taxes		280
		280
Less: Preference dividend		34
Net Profit for Equity shareholders		246
Add: Reserves at April 1, 2014		364
		610
Less: Dividend paid to Equity Shareholders		50
Reserves at March 31, 2015		560

The Ratios of Kodiac Ltd. For the years ended March 31 and their Industry Average ratios and are given below:

	2012-13	2013-14	2014-15	Industry Average 2014-15
Current Ratio	2.54	2.10		2.30
Acid-test Ratio	1.10	0.96		1.20
Debtors Turnover	6.00	4.80		7.00
Stock Turnover	3.80	3.05		3.85

Long-term Debt to total Capital	37%	42%		34%
Gross Profit margin	38%	41%		40%
Net Profit Margin	18%	16%		15%
Return on Equity	24%	29%		19%
Return on Total Assets	7%	6.8%		8%
Tangible Assets turnover	0.80	0.70		1.00
Interest Coverage	10	9		10

Required:
(1) Complete the financial Ratios Calculation for the year 2014-15.
(2) Analyse the financial performance of the company and
(3) Offer year suggestions to the management for improvements in performance.

4+4+2=10

(b) The following details are extracted from the records of SRIJAN CEMENT LTD. For the year that ended as follows:

Year ended March 31	2015	2014
Installed Capacity per Annum (in Tonnes)	200000	200000
Capacity Utilization	87%	95%
Consumption of coal per tonne of output	39%	35%
Consumption of Electricity/Tonne of output (KWH)	4.07	3.98
Capital Employed (₹ in Lakh)	1,200	1,100
Profit (₹ in Lakhs)	290	400
Salaries & wages (₹ in Lakh)	117	98
Production (Tonnes)	174000	190000

Based on the foregoing information you as a Cost Auditor of the Company are required to offer your observations and suggestions for improvement in performance. 8+2=10
(you may make necessary assumptions)

(c) TEXTILE MILLS LTD. has been having low profit. The Company appointed a special task force to review performance and prospect of improving the profitability of the Company. The task force submitted the following report to the company.
(1) The company has 1440 looms working in two shifts per day. There are 30 sections of 24 looms each working in two shifts. Each such section has 25 weaver and a jobber. Thus there are 1560 direct labourers other than indirect labourers.
(2) The working time is between 7 a.m. and 12 mid night comprising 2 shifts of 8 hrs. each with a half hour interval between shifts.
(3) The production cloth is 21.60 lakh metres per month and the realisation is ₹ 4.30 per metre.
(4) The average wage of direct labourers is ₹ 1200 per month and the fixed cost amounting to ₹ 2,90,000 per month. The product cost is ₹ 2.75 per metre in addition to direct wages.

The following suggestions/advised are to be considered for improvement:
(a) Labour productivity can be improved by changing lay out of the machines.
(b) Given the space available with proposed change in layout only 1008 looms can be re-installed with 48 looms in each section.
(c) Technically a section of 48 looms can run with 13 weavers, a helper and a jobber. It will be necessary to increase the wages of direct labourers for such sections by ₹ 140

per head per month. The company is not going to retrench the labour at present.

(d) The company can run a third shift between 12 mid night to 7 a.m. in the morning with a half hour interval. However eight hours wages are to be paid for six and half hour for the night shift.

(e) As an initial step the company can switch to three shift workings with 11 sections having 26 direct labourers each shift and 10 sections having 15 direct labourers each shift. Excess hands can be planned for retirement or may leave the job voluntarily. The production for three shift workings will be 26.10 lakh metres. Additional fixed cost will be ₹ 50,000 per month for third shift.

(f) Only 21.60 lakh metres can be sold at present price of ₹ 4.30 per metre and additional cloth of 4.50 lakh metres can be exported at ₹ 3.80 per metre, as there is an export offer.

Examine the implications of the proposals for company's profit and give your advice to the company. 8+2=10

Answer:

3. (a)

KODIAC LTD.

Calculation of Ratios: (Amount in ₹ Lakh)

1	Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{140+700+980}{840+80+200} = \frac{1820}{1120}$	=1.63
2	Acid-test Ratio	$\frac{\text{Liquid Assets}}{\text{Liquid Liabilities}} =$ $\frac{\text{Current Assets - Stock}}{\text{Current Liabilities - Bank Overdraft}} = \frac{1820-980}{1120} = \frac{840}{1120}$	=0.75
3	Debtors turnover	$\frac{\text{Net Credit Sales}}{\text{Average Accounts Receivable}} = \frac{2240}{700}$	=3.20
4	Stock turnover	$\frac{\text{Cost of Goods Sold}}{\text{Average Inventory}} = \frac{1680}{980}$	=1.71
5	Long-term debt to total capital	$\frac{\text{Long Term Debt}}{\text{Share Holder's Equity + Debt}} = \frac{1680}{560+560+1680} = \frac{1680}{2800}$	=60%
6	Gross Profit Margin	$\frac{\text{Revenue - Cost of Goods Sold}}{\text{Revenue}} = \frac{2800-1680}{2800}$	=40%
7	Net Profit Margin	$\frac{\text{Net Profit}}{\text{Revenue}} = \frac{280}{2800}$	=10%
8	Return on equity	$\frac{\text{Net Income}}{\text{Share Holder's Equity}} = \frac{246}{560+560} = \frac{246}{1120}$	=21.96%
9	Return on total Assets	$\frac{\text{EBIT (Net Income + Interest + Taxes)}}{\text{Total Net Assets - Goodwill}} = \frac{560+84}{4200-280} = \frac{644}{3920}$	=16.43%
10	Tangible Assets Turnover	$\frac{\text{Total Turnover}}{\text{Tangible Assets}} = \frac{2800}{4200-280}$	=0.71
11	Interest coverage	$\frac{\text{EBIT}}{\text{Interest}} = \frac{560+84}{84}$	=7.67

* Value of Intangible assets is excluded:

Evaluation of Financial Performance of the company.

(1) Liquidity position of the company is falling and is lower than industry's average which is evident from ratios (SL. No. 1 to 4).
(2) The gross profit margin is constant and matches with the industry average. (SL. No. 6 of ratio) but net profit margin ratio (SL. No. 7) is declining and lower than the industry average. The ratios together imply that the company's selling and administrative expenses, depreciation and interest charges are rising.
(3) The decline in the net margin is partly due to rapid increase in debt (SL. No.5) which is substantially higher than industry average. This increase also explains why the return on equity ratio (SL. No. 8) has been rising while the return on total assets ratio is increasing which is higher than the industry average (SL. No. 9). The decline in the net margin can be attributed to the decline in assets turnover Ratio (SL.No.10).

    The impact of the increase in debt and overall decline in profitability are also shown by reduction in the interest coverage ratio (SL. No.11) which is lower than the industry average.
    So, overall financial performance of the Company is not sound or impressive.

Suggestions:

The Management is advised to:

(i) Increase production so that cost of production can be cut.
(ii) Reduce long term debt so that interest burden can be declined.
(iii) Take steps to arrest declining trends in both the solvency ratios positions.
(iv) Reduce selling and sales promotion expenses and Administrative expenses.
(v) Improve the efficiency of inventory management.
(vi) Prompt debt collection to increase liquid fund.
(vii) Take steps for arresting the slow -moving and non-moving inventory.
(viii) Finance from long term funds for core current assets according to Principles of sound financial management.
(ix) Take remedial measure to use optimum capacity in future.

3. (b) COST AUDITOR'S Observations and suggestion are as under:

	2014-15	2013-14
(i) Profit as a % of Capital Employed	(₹290 lakh)/(₹1200 lakh)x100 =24.17	(₹400 lakh)/₹1100 lakh x 100 =36.36%

It is noticed that the profitability ratio during 2014-15 has considered come down by 12.19% as compared to 2013-14 ratio. Two factors have contributed to downward trend.

(1) Profit has come down from ₹ 400 lakh in 2013-14 to ₹ 290 lakh in 2014-15.
(2) Capital employed has gone up by ₹ 100 lakh in 2014-15 as compared to earlier year (2013-14).

The low profitability position during 2014-15 may be due to the following factors:-

(a) Increase in cost inputs:

During 2014-15 the consumption of Coal per Tonne of output is up by 4% as compared to consumption of year 2013-14.

In addition, wages and salaries has gone up by ₹ 19 lakh despite reduced production in 2014-15. This may be due to the following reasons:

- Increase in ₹ 8 lakh due to increments and promotions (assumptions)
- Increase in ₹ 3 lakh due to additional DA paid to workers (Assumptions)
- Increase is ₹ *8* lakh (Remaining) due to employment of new workers (Assumptions)

Additional work needs to be created for these workers.

(b) Reduced Production:

During the year 2014-15 production has decreased by 16000 tonnes as compared to year 2013-14 production.

This may be due to -

- Plant breakdown
- Idle time of workers
- Power failure
- Lower grade of materials

The capacity utilization during the year 2014-15 is also lower by 8% as compared to the year 2013-14 figure due to lack of adequate production planning and control.

(c) Higher Capital Employed in 2014-15:

This may be due to capital additions or higher requirements of working capital. This has not resulted in increased productivity.

The Management is advised to increase production so that cost of production and sales can be cut, capital is fully employed and consequently profit can be improved. Unused or idle or unwanted machinery should be sold out.

(ii) Coal Consumption*:*

The higher consumption of coal during the year 2014-15 by 4% as compared to the year 2013-14. This may be due to

- High ash content in coal
- Inferior quality of coal used
- Improper maintenance of the boiler

• The Management is advised to purchase good quality of coal.

Proper repair and maintenance of the Boiler should be carried out urgently.

(iii) Consumption of Electricity:

The consumption of electricity in terms of KWH/Tonne of cement has increased from 3.98 KWH in 2013-14 to 4.07 KW in 2014-15. This is a serious matter which needs investigation and necessary actions is to be initiated.

(iv) Fall in capacity utilization

The installed capacity is 200000 Tonnes.

During the current year (2014-15) the capacity utilization has come down by 8% i.e. there is a loss of production by 16000 tonnes. This may be due to the following reasons:-

- Major breakdown in the plant
- Frequent power cuts
- Inadequate preventive maintenance
- Inadequate production planning and control
- Idle time of labour
- Poor quality of materials

The management should immediately take remedial measure to use optimum capacity in the next year.

3. (c)

TEXTILE MILLS LTD.

Statement showing the comparative profitability (per month)

(A) Particulars	**Present**	**Proposed**
No. of Looms	1,440	1,008
No. of Shifts	2	3
No. of Sections	30	21*
No. of Sections (with 26 hands in each section @ 1200 p.m.)	30	11
No. of sections (with 15 hands in each section @ ₹1340 per head p.m.)	-	10
Total number of direct labourers employed	1,560	1,308
Expected production (lakh metres p.m.)	21.60	26.10

(*1008/48)

(B) Particulars	**Present (₹)**	**Proposed (₹)**
Sales Revenue (a)	92,88,000	1,09,98,000
Costs:		
Production cost @ ₹2.75	59,40,000	71,77,500
Direct Wages	18,72,000	16,32,600
Fixed Costs	2,90,000	3,40,000
Total Costs (b)	81,02,000	91,50,100
Profit (a)-(b)	11,86,000	18,47,900

Suggestion/Advice:

In consideration of comparative profitability stated supra, it is revealed that with the proposed plan of action the profit of the company has increased by ₹661900 (₹1847900-₹1186000).

Hence, the proposal is recommended for implementation.

Working Notes:

1. No. of Sections = No. of Looms/Looms per section = 1008 looms/48 looms= 21sections.
2. No. of labourers employed
   No. at present (26 persons x 30 sections x 2 shifts) = 1560 persons
   Proposed [26x11 x3) + (15x10x3) = 1308 persons
3. Direct Wages (per month)
   Present (1560x1200) = ₹ 1872000
   Proposed [(858x1200)] + (450x1340) = ₹ 1632600
4. Sales revenue per month
   Present (21.60x ₹ 4.30) = ₹ 92.88 lakh
   Proposed [(21.60x4.30) + (4.50x3.80)] = ₹109.98 lakh