FINAL EXAMINATION

GROUP IV

(SYLLABUS 2012)

SUGGESTED ANSWERS TO QUESTIONS

DECEMBER 2016

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.

SECTION – A has one question which is compulsory. Attempt this question.

SECTION – B has seven questions. Attempt any five of them.

Working Notes should form part of the respective answers.

Wherever necessary, suitable assumptions may be made and disclosed by way of a note.

Please: (1) Answer all bits of a question at one place.

(2) Open a new page for answer to a new question.

SECTION A (20 Marks)

Answer the following:

1. (a) Fill in the blanks in the following sentences by using appropriate word(s)/ Phrase(s) /number(s): 1×5 =5

(i) The Cost Audit Report is required to be in conformity with the 'Cost Auditing Standards' as referred to in section __________of the Companies Act, 2013.

(ii) Power generation. Telecommunication services fall in _____________ sector as per Companies (Cost Records and Audit) Rules, 2014.

(iii) The FOREX component of imported material cost shall be converted at the rate on the date of the ______________.

(iv) The review of Organization Plan, Policies, Structure are done through ________audit.

(v) Cost Accounting Standard on Cost of Service Cost Centre is dealt in ____________.

(b) State whether the following statements given below are TRUE or FALSE: 1×5=5

(i) Part-D Para-4 of the Annexure to cost Audit Report under the companies (Cost Records and Audit) Rules 2014 deals with Profit Reconciliation (for the company as a whole).

(ii) Cost Audit and Management Audit are one and the same.

(iii) Main objective of Internal Audit is to prevent errors and frauds.

(iv) Government Audit does not comment on economy and efficiency other than viewing on fairness of financial statement.

(v) A Limited liability partnership firm registered under the Limited Liability Partnership Act, 2008 can be appointed as Cost Auditor of a company.

(c) Answer any five of the following in one or two sentences: 2×5=10

(i) The Cost Auditor of a company was offered to act as ERI (e-Return Intermediary) for filing income tax related matter on behalf of one of its subsidiary company. Can the Cost Auditor accept the assignment?

(ii) Explain 'Corporate Development Audit.'

(iii) Whether the companies (Cost Records and Audit) Rules 2014 is applicable to a company which is generating electricity for captive use?

(iv) How would you treat demurrage charges as per CAS-15?

(v) What is the time limit within which the cost Auditor of the company should submit his report?

(vi) Whether all petroleum products are covered under the Companies (Cost Records and Audit) Rules, 2014?

Answer: 1

(a) (i) 148 (ii) Regulated (iii) Transaction (iv) Management (v) CAS - 13

(b) (i) False (ii) False (iii) False (iv) False (v) True

(c)

(i) Any person who is engaged in consulting and providing specialised services to the company and its subsidiary companies becomes ineligible to act as cost auditor. (Sec. 141 and 144 of the Companies Act, 2013). The Cost Auditor cannot accept the assignment as long as he remains appointed as cost auditor of the company.

(ii) A corporate development audit is an independent objective study of an organization's capabilities. Corporate development audit is a comprehensive task to assist the corporate management in various aspects of development through a process of systematic review and evaluation of long-term strategies of the company.

(iii) The companies (Cost Records and Audit) Rules 2014 is applicable to a company which is engaged in Generation, transmission, distribution and supply of electricity regulated by the relevant regulatory body or authority under the Electricity Act, 2003 (36 of 2003); other than for Captive generation.

(iv) As per CAS-15 relating to selling and distribution overheads, any demurrage or detention charges, or penalty levied by transportation or other authorities in respect of distribution activity shall not form part of the selling and distribution overhead.

(v) As per rule 6 (5) of the Companies (Cost Records and Audit) Rules 2014, every Cost Auditor shall forward his report to the Board of Directors of the Company within a period of one hundred and eighty days from the closure of the financial year to which the report relates.

(vi) The Companies (Cost Records and Audit) Rules, 2014 is applicable to all petroleum products regulated by the Petroleum And Natural Gas Regulatory Board Act, 2006 (19 of 2006) and covered under CETA Heading No. 2709 to 2715.

SECTION B (80 Marks)

Answer *any five* questions (carrying 16 marks each) from question no. 2 to question no. 8.

2. (a) MITHAS LTD. is a top sugar manufacturer and exporter in India operating from Noida Special Economic Zone, Uttar Pradesh. Its revenue from sale/export for the current year

is given below:

Sale within India	**₹153 lakhs**
Sale outside India (Export)	**₹357 lakhs**
Total revenue	**₹510 lakhs**

Mr. X, the statutory auditor of Mithas Ltd., is of the view that the company is mandatorily required to include cost records in their books of account and consequently conduct cost audit. He also suggested the name of his friend, who is a Cost Accountant in Practice, for the purpose of such cost audit. However, the management is of the view that the company neither required including cost records in their books of account nor conduct cost audit.

Being an expert in cost record and audit rules, you are required to guide the management in this regard. 6

(b) The cost accountant of URASHI LTD. a cement company has arrived at a profit of ₹ 732,40,000 based on cost accounting records for the year ended March 31, 2016. In the course of Cost Audit you come the following differences between the Financial Accounts and Cost Accounts:

(Amount in ₹ Thousand)

(i)	Loss on Sale of Fixed Assets	61
(ii)	Profit on Sale of investments	1,200
(iii)	Donation paid	200
(iv)	Loss from Retail trading activity	5,100
(v)	Voluntary retirement compensation included in salary and wages in financial accounts	16,800
(vi)	Major repair and maintenance written off in Financial Accounts (Amount reckoned in cost accounts of ₹6,100 thousand for this job)	10,300
(vii)	Insurance claim relating previous year received during the year	14,300
(viii)	Element of profit on self consumption of cement included in financial accounts	720
(ix)	Interest income from inter-corporate deposits	6,100
(x)	Increase in value of work-in-progress and finished goods inventory was as follows: (₹ in Thousand) As per Financial Accounts 9,200 As per Cost Accounts 6,150	

You are required to prepare a Reconciliation Statement and arrive at the profit as per financial accounts for the year ended March 31, 2016. 4+5+1=10

Answer: 2

(a) Applicability of Provisions related to Cost Records and Audit : The Provisions relating to Cost records and audit are governed by section 148 of the Companies Act, 2013 read with the Companies (Cost Records and Audit) Rules , 2014. The audit conducted under this section shall be in addition to the audit conducted under section 143.

Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 provides the classes of companies, engaged in the production of goods or providing services, required to include cost records in their books of account .The said rule has divided the list of companies into regulated sectors and non-regulated sectors. Company belonging to sugar industry is one of the types of companies prescribed under the regulated sectors.

However as per Rule 4(3) of the Companies(Cost Records and Audit) Rules 2014, 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, exceed, seventy five per cent of its total revenue; or (ii) which is operating from a special economic zone."

In the given case, Mithas Ltd, a sugar manufacturer and exporter in India, is operating from Noida Special Economic Zone, Uttar Pradesh.

Therefore, Mithas Ltd Is required to include cost records in their books of account in accordance with Rule 3 of the companies (Cost Records and Audit) Rules, 2014. However, the company is not required to conduct cost audit as it is operating from a special economic Zone. The facts given on revenue are not relevant here.

(b) **URASHI LTD.**

RECONCILIATION OF FINANCIAL PROFIT AND COSTING PROFIT FOR THE YEAR ENDED MARCH 31, 2016:

(Amount in ₹thousand)

Profit As Per Cost Accounting Records		73240
(1) Add: Incomes Not Considered In Cost Accounts:		
(i) Profit on sale of Investments	1200	
(ii) Insurance Claim received relating to previous year	14300	
(iii) Interest income from Inter-Corporate deposits	6100	
(iv) Element of profit on self-consumption of cement	720	22320
		95,560
(2) Less: Expenses not considered in Cost Accounts:		
(i) Loss on sale of Fixed Assets	61	
(ii) Loss from Retail Trading Activity	5100	
(iii) Voluntary Retirement Compensation included in Salary & Wages	16800	
(iv) Donation paid	200	
(v) Part of Repairs and Maintenance cost excluded in Cost Accounts (10,300-6,100)	4,200	(26,361)
(3) Add: Difference in valuation of stock (WIP & F. Goods)		
Increase in inventory as per Financial A/C 9200		
Increases in inventory as per Cost A/C 6150		
Higher valuation in Financial A/Cs	3050	3050
Profit As Per Financial Accounts		72,249

3. (a) **What disclosures are required to be made in cost statement as per CAS-20 as regard to Royalty and Technical know-how fee?** **5**

(b) **SHARATHI LTD. a tyre and tube manufacturing company is having turnover of ₹75 crores from all its activities. The company has filed its prospectus with SEBI for a public issue of equity shares and it hopes to complete the public offering by September, 2015 end.**

Whether cost audit will become applicable to the company? If yes, then from which financial year will cost audit become applicable? **6**

(c) **Explain what is the procedure for appointment of a cost auditor of the company under the Companies Act, 2013.** **5**

Answer 3:

(a) As per CAS-20 on Royalty And Technical Know-How-Fee, the cost statements shall disclose the following:

1. The basis of distribution of the amount of Royalty and Technical Know-how Fee to the cost objects/ cost units.
2. Quantity and the related rate of items of the amount of Royalty and Technical Know-how fee as applicable.
3. Royalty and Technical Know-how fee paid/ payable to related parties.
4. Royalty and Technical Know-how fee incurred in foreign exchange.
5. Any Subsidy/Grant/Incentive and any such payment reduced from the amount of Royalty and Technical Know-how fee.
6. Credits/recoveries relating to the amount of Royalty and Technical Know-how fee.
7. Penalties and damages excluded from the amount of Royalty and Technical Know-how fee

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

Any change in the cost accounting principles and methods applied for the measurement and assignment of the amount Royalty and Technical Know-how fee during the period covered by the cost statement which has a material effect on the amount of Royalty and Technical Know-how fee. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.

(b) As per Rule 4(2) of the Companies(Cost Records and Audit) Rules , 2014, Cost Audit is applicable to the non- regulated sectors 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.**

Conclusion:

(i) In this case the company does not fall under the criteria mention under Rule 4 (2) of the Companies (Cost Records and Audit) Rules, 2014. Hence it is not required to undertake cost audit.

(ii) The company is in the process of listing on a stock exchange in India which will nowhere affect the applicability of the Companies (Cost Records and Audit) Rules, 2014. Hence, the company is not required to get its cost records audited.

(c) 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 Board of Directors of the Companies as specified in Rule 3 and the thresholds limits laid down in Rule 4, shall within one hundred and eighty days of the commencement of every financial year (i.e., on or before 30th September), appoint a cost auditor. [Rule 6(1)]

The company referred to in rule 6(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 (i.e., **on or before 30th September**), whichever is earlier, through electronic mode, in **Form CRA-2**, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014. [Rule 6(2)]

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. The following figures are extracted from the Books of VENNELA LTD., a Multi products Company mainly producing Cement and Ready-mix Concrete for the years ended

March 31, 2016 and 2015.

Year ended 31st March	2016	2015
Particulars	**(Amount in ₹ Millions)**	
Gross Sales including Excise Duty :	**7,720**	**6,180**
Excise Duty	**600**	**480**
Other Income	**450**	**300**
Export Incentives	**80**	**60**
Increase in Value of Stock of Finished Goods	**30**	**15**
Raw materials consumed	**2,640**	**2,160**
Direct wages, salaries, bonus, gratuity etc.	**660**	**528**
Power & Fuel	**360**	**288**
Stores and spares	**240**	**210**
Other manufacturing overheads	**645**	**555**
Administrative Overheads :		
Audit fees	**54**	**45**
Salaries & commission to directors	**72**	**60**
Other overheads	**390**	**330**
Selling and distribution overheads :		
Salaries & Wages	**54**	**45**
Packing and forwarding **Other overheads**	**30** **375**	**24** **300**
Total depreciation	**180**	**180**
Interest Charges :		
On working capital loans from Bank	**90**	**75**
On fixed loans from IDBI	**135**	**105**
On Debentures	**45**	**45**
Tax paid including provisions	**474**	**300**
Dividend paid	**630**	**345**
Dividend Distribution Tax	**110**	**60**

You are required to calculate the following parameters as stipulated PART-D, PARA-3 of the Annexure to Cost Audit Report under the Companies (Cost Records and Audit) Rules, 2014 for the year ended March 31, 2016 and March 31, 2015:

(i) Value addition

(ii) Earning available for Distribution

(iii) Distribution of Earning to the different claimants **8+1+7=16**

Answer 4:

Annexure to Cost Audit Report:-

Part D-3: Value Addition And Distribution Of Earnings (For **Vennela Ltd.** as a whole)

(Amount In ₹ Millions)

Sl. No.	Particulars	Current Year 2015-16	Previous Year 2014-15
	Value Addition:		
1.	Gross Sales including Excise Duty	7720	6180
2.	Less: Excise Duty etc.	600	480
3.	Net Sales	7120	5700

4.	Add: Export incentives	80	60
5.	Add:/ (Less) Adjustment In Finished Stocks	30	15
		7,230	**5,775**
	Less: Cost of bought out input: (a) Cost of Raw materials consumed (b) Consumption of stores and spares (c) Power & Fuel (d) Other overheads (645+54+390+30+375+90) = 1584 (555+45+330+24+300+75) = 1329	 2,640 240 360 1,584 -	 2,160 210 288 1,329 -
	Total cost bought out inputs	4,824	3,987
7.	**VALUE ADDED:**	**2,406**	**1,788**
8.	Add: Other income	450	300
9.	Add: Extra ordinary income	---	-----
10.	**Earnings available for distribution**	**2,856**	**2,088**
(1)	**Distribution of earnings to:** Employees as salaries and wages, bonus, gratuity etc. Directors- Salaries and commission	 714 72	 573 60
(2)	Shareholders as dividend	630	345
(3)	Company as retained funds (including depreciation)	676	600
(4)	Government as taxes Dividend Distribution Taxes Income taxes paid (including provisions)	 110 474 584	 60 300 360
(5)	(1) Providers of Capital/Fund as interest on Debentures: Interest on debentures: Interest on Fixed loans from IDBI	 45 135 180	 45 105 150
	Total distribution of earnings	**2,856**	**2,088**

5. (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 corporates towards environment pollution control and the treatment of costs as per CAS-14. 5+3=8

(b) ABUNA ELECTRONICS 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, 2016.

(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:

(i) 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

(ii) Also Assessable Value for the purpose of paying excise duty on Captive Consumption. 6+2=8

Answer 5:

(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 resides 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

(a) **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,

(b) **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,

(c) **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.

Presentation:

Pollution Control cost, if material, shall be presented in the cost statement as a separate item of cost.

The cost statements shall disclose the following:

- The basis of distribution of Pollution Control cost to the cost objects/ cost units.
- Where standard cost is applied in Pollution Control cost, the price and usage variances.
- Pollution Control cost of Jobs done in-house and outsourced separately.
- Pollution Control cost paid/ payable to related parties .
- Pollution Control cost incurred in foreign exchange.
- . Any Subsidy / Grant / Incentive or any amount of similar nature received / receivable reduced from Pollution Control cost.
- Any credits / recoveries relating to the Pollution Control cost.
- Any abnormal portion of the Pollution Control cost.
- Penalties and damages excluded from the Pollution Control cost.

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

(b) **ABUNA ELECTRONIC LTD.**

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**

6. (a) When the internal auditor uses the work of an expert, what precautions he should undertake? 6

(b) Explain what are the objectives of Operational Audit. 6

(c) What do you understand by "Audit Risk" as per Cost Auditing Standard-101 on 'Planning an Audit of Cost Statements'? 4

Answer: 6

(a) SIA 16 issued by ICAI gives guidelines for using the work of an expert:

If the internal audit team does not possess necessary knowledge, skills, expertise or experience needed to perform all or part of the internal audit engagement, it can obtain technical advice and assistance from competent experts;

- When the internal auditor uses the work of an expert, he should satisfy himself about the competence, objectivity and independence of such expert and consider the impact of such assistance or advice on the overall result of internal audit engagement, especially in cases where the outside expert is engaged by senior management or those charged with governance.
- When determining whether to use the work of an expert or not, internal auditor should

consider the materiality of the item being examined, the nature and complexity of the item including the risk of error therein, the other internal audit evidence available with respect to the item.

- When the internal auditor plans to use the expert's work, he should satisfy himself as to the expert's skills and competence. To consider the objectivity of the expert to satisfy himself that the expert has no personal, financial or organizational interests that will prevent him from rendering unbiased and impartial judgments and opinion.
- When the internal auditor intends to use the work of an expert, he should gain knowledge regarding the terms of the expert's engagement. To seek reasonable assurance that the expert's work constitutes appropriate evidence in support of the overall conclusions formed during the internal audit engagement. To consider whether the expert has used source data which are appropriate in the circumstances.
- In exceptional cases where the work of an expert does not support related representations in the overall systems, procedures and controls of the entity, the internal auditor should attempt to resolve the inconsistency by discussions with the auditee and the expert. The internal auditor should not, normally, refer to the work of an expert in the internal audit report.

(b) The general objectives of operational audit are -

i. **Appraisal of controls:**

(a) Internal controls provide the essential tools / measures to ensure proper performance in each functional or organizational area for accomplishing the desired organizational objective.

(b) The purpose of operational audit is to determine whether the controls are - (i) adequate,, and (ii) effective in accomplishing management's objectives or plans or operations.

(c) The operational auditor reviews internal controls and reports to ascertain whether they bring the performance, qualitatively and quantitatively, to the notice of the management, also within the organisation's policies and plans are being carried out.

ii. **Evaluation Of Performance:** In the area of performance appraisal, the operational auditor is basically concerned with -

(a) Analysing the technical efficiency of the operations,

(b) Accumulating information and evidence to measure the effectiveness, efficiency and economy of operations, and

(c) Comparing actual performance with applicable standards, procedures, Rules, policies and plans.

(d) Performance evaluation is generally based on - (i) productivity, (ii) personnel, (iii) workload, (iv) cost, & (v) quality.

iii. **Appraisal Of Management Objectives And Plans:**

(a) Every activity in an organization is the product of basic plans and objectives set by the management. Hence, management policies, plans and objectives should be evaluated properly.

(b) The aim of operational auditing is to appraise operations and controls and adherence to prescribed and laid-down policies and not to go into the question of appropriateness of plans and objectives. But, the operational auditor may look into aspects like -

- Clarity of objectives
- Proper communication of objectives to the personnel responsible for implementation,
- Feedback from personnel, i.e. whether they have understood the objectives in the same sense as meant by the management, and
- Apparent conflict in the objectives and its effect on operations.

iv. **Appraisal of organization structure:**

(a) Organisational structure, an essential element of internal control design, provides the line of relationships and delegation of authority and tasks.

(b) The operational auditor should consider the following in evaluating the organization structure-

- Conformity with management objectives,
- Proper match between responsibility and authority
- Clear definition of scalar line of authority from top to bottom, and
- Possibility of defective delegation overlapping or duplication of work

Alternate answer as per study material

An operational audit (or value-for-money audit) has been defined as an organized search for ways of improving efficiency and effectiveness. The objective is to assist the organization in performing functions more effectively and economically with focus on the efficiency and effectiveness of operations, it is also stated to be an early warning system for the detection of potentially destructive problems. An operational audit can lead to better management of all aspects of business organisation whether it is production area or service area.

However, an operational audit tends to answer the questions as to why the entity is where it is and how it got there. It means the evaluation of management's performance and efficiency. Therefore, Operations Audit is a process to determine ways to improve production. It falls into the category of a management service by evaluating the four functions of management: (1) planning, (2) organizing, (3) directing, and (4) controlling. The operational audit can also be broken down further as a functional review; for example, Purchasing as a department versus the overall Procurement operation in coordination with production scheduling and market forecasting.

Operational audits concerned with the objectives of efficiency and effectiveness. There are many reasons for performing an operational audit: compliance with policies and procedures, excessive sales returns, proposed product mix, equipment down time or personnel turnover etc. Therefore, an auditor must establish the scope of an operational audit before formulating the approach to initiate an operational audit. This step will determine the extent of the scope of audit. The second step shall be to understand the auditee's operation, its purpose in the total environment of the entity, its history, its image, its staff, their skills and competence and its reporting path. The reporting path is of very critical importance because this path is the communication route along which, the audit results and conclusions will flow.

The prime records to be obtained in an operational audit are the organizational chart of the function/ operation, applicable policies, guidelines and procedures etc. These will outline each employee's responsibility and authority. The function's/operation's performance reports for the reasonable period prior to the audit should be reviewed to do trend analyses or the critical analyses. These analyses or reports could indicate potential critical areas such as over- or under-staffing, noncompliance with corporate policies and procedures, weaknesses in internal controls, or inadequate job rotations etc. These indications could help the management auditor in determining scope of investigation and areas of potential improvement. Reports must be based on facts, informative, submitted in time and directed to the proper levels of management.

(c) As per Cost Auditing Standard- 101, Audit Risk is the risk that the cost auditor expresses an inappropriate audit opinion on the cost statements that are materially misstated. Audit risk is a function of the risk of material misstatement and detection risk.

(a) 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 entity's internal, operational and management control.

(b) Detection risk: the risk that the procedures followed by the cost auditor to reduce audit risk to an acceptable low level will not detect a misstatement that (i) exists and that could be material, either individually or when aggregated with other misstatements.

7. (a) The term 'Image' in relation to a company refers to how it is perceived by the public at large.
Keeping this in mind how would a Management Auditor approach to evaluate the Corporate Image of a company?
Discuss the technique available to the Management Auditor to evaluate the Corporate Image. 4+4=8

(b) ASHIRBAD 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, 2016:

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, 2016. 8

Answer 7:

(a) The various approaches to be taken by the Management Auditor to evaluate the Corporate Image of the company are as follows:-

(i) He should prepare a list of desirable attributes.
(ii) The attributes should be classified into main groups and each group dovetailing the specific qualifications.
(iii) Weights should be assigned to the attributes according to relative importance or priority

but keeping in mind the aspects of objectivity, relevance, and materiality that might have an impact on image of the corporate sector.

(iv) The attributes should then be rated based on facts, judgments and technical studies made by experts in respective fields.

(v) The ratings are summarized under the selected groups.

(vi) The results are then presented to the management giving a comparative picture between actual and anticipated results.

Thus in order to arrive at the proper evaluation on a number of factors arbitrarily on the subject, a management auditor has to apply a greater degree of skill in factual analysis. His approach for evaluation of corporate image should include attributes of dealing with financial stability, production efficiency, sales effectiveness, economic and social affluences, personal satisfaction and development growth in earnings, public relations and civic responsibility.

The techniques available to the management auditor for carrying out the evaluation of corporate image are as follows:-

a) **Graphical method:** Upto date graphs are maintained for each of the attributes of a public under evaluation (i.e. Product, consumers, shareholders, lenders);
b) **Point method**: Points are attached to each attribute concerning a profile and scaling them.
c) **Index method**: Ideal indices are developed and actual attributes are compared with them.
d) **Survey method**: It indicates questionnaires to elicit information.
e) **Ratio analysis:** Analysis of events and trends with help of ratios.
f) **Position analysis:** Position of an enterprise with regard to market size, market share, market stability'.
g) **Method of comparison:** Comparison of actual with budget on quantifiable attributes. It also includes inter-firm comparison within same class of industry.

(b) **ASHIRBAD CEMENT LTD**

STATEMENT SHOWING COST OF POWER GENERATED BY POWER GENERATED PLANT FOR YEAR ENDED MARCH 31, 2016

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)/15 Yrs.	96000		
Boiler House (600000/10 Yrs.)	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

8. (a) TROMA LTD., a manufacturing unit, produces two products PB and PS. The following information is extracted from the Books of the Company for the year ended March 31, 2016:

Particulars	Product PB	Product PS
Units Produced (Qty.)	**2,10,000**	**1,68,000**
Units sold (Qty.)	**1,68,000**	**1,36,500**
Machine hours utilized	**1,26,000**	**84,000**
Design charges (₹)	**1,57,500**	**1,89,000**
Software development charges (₹)	**2,62,500**	**3,78,000**

(i) Royalty paid on sales ₹6,09,000 [@ ₹ 2 per unit sold for both the products].

(ii) Royalty paid on units produced ₹3,78,000 [@ ₹1 per unit produced for both the products].

(iii) Hire charges of equipment used in the manufacturing process of product PB only ₹53,000.

***Note:* No adjustments are to be made related to units held i.e. Closing Stock.**

You are required to compute the DIRECT EXPENSES—keeping in view of Cost Accounting Standard (CAS)-10. 6

(b) Who is the approving authority of the Company to fix the remuneration of the Cost Auditor? 3

(c) Write a note on "Audit Committee" under the Companies Act, 2013 in brief. 7

Answer 8: (a)

TROMA LTD.

Computation of Direct Expenses (As per CAS – 10)

(Amount in ₹)

Particulars	Product PB	Product PS
Royalty paid on sale	336000	273000
Add: Royalty paid on units produced	210000	168000
Add: Hire charges of equipment used in the manufacturing process of product-PB only	53000	--------
Add: Design charges	157500	189000
Add: Software development charges related to production	262500	378000
Direct expenses (total)	**1019000**	**1008000**

(b) **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 –

(b) 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;

(c) 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;

(d) 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 (i) practice or a firm of cost accountants in practice as cost auditor and remuneration of such cost auditor shall be ratified by the shareholders subsequently.

(c) 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,—

(i) The recommendation for appointment, remuneration and terms of appointment of auditors of the company;

(ii) Review and monitor the auditor's independence and performance, and effectiveness of audit process;

(iii) Examination of the financial statement and the auditors' report thereon;

(iv) Approval or any subsequent modification of transactions of the company with related parties;

(v) Scrutiny of inter-corporate loans and investments;

(vi) Valuation of Undertakings Or Assets of the Company, wherever it is necessary;

(vii) Evaluation of internal financial controls and risk management systems;

(viii) Monitoring the end use of funds raised through public offers and related matters.

(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 victimisation 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.