

FINAL EXAMINATION

GROUP IV

(SYLLABUS 2016)

SUGGESTED ANSWERS TO QUESTIONS

DECEMBER 2018

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.

*Answer Question No. 1 which is compulsory and carries 20 marks and
any five questions from Question Nos. 2 to 8*

SECTION – A (20 Marks)

1. Choose the correct answer with short justification/workings. (1 mark for correct choice and 1 mark for justification/working) 2x10= 20
- (a) Before submission to the Auditor for Report, the Form CRA 3 should be signed by _____.
- (A) The Secretary and the Chief Finance Officer of the company.
 - (B) The Secretary and the Cost Accounts Officer of the company.
 - (C) The Secretary and one Director of the company.
 - (D) The Chief Finance Officer and the Managing Director of the company.
- (b) Cost of self-generation utilities for own consumption shall comprise _____.
- (A) Administrative overheads.
 - (B) Distribution cost
 - (C) Factory overheads
 - (D) None of the above.
- (c) The useful life of an intangible asset, like amount paid on technical knowhow, shall not exceed _____ from the date it is available for use.
- (A) 5 years
 - (B) 8 years
 - (C) 10 years
 - (D) 12 years
- (d) Product and Profitability Statement (for audited products/services) is shown under _____ of Annexure to the Cost Audit Report.
- (A) Part A
 - (B) Part B
 - (C) Part C
 - (D) Part D
- (e) Cost Audit Documentation is dealt in the _____
- (A) Cost Auditing Standard 101
 - (B) Cost Auditing Standard 102

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- (C) Cost Auditing Standard 103
(D) Cost Auditing Standard 104
- (f) A member of The ICAI shall be deemed to be guilty of other misconduct, if he/she is held guilty by any civil or criminal court of an offence which is punishable with imprisonment _____.
- (A) For a term exceeding 3 years
(B) For a term exceeding 3 months
(C) For a term exceeding 6 months
(D) For a term exceeding 2 years
- (g) Costing Taxonomy is best defined as a _____.
- (A) Dictionary
(B) Made Easy
(C) Tax Ready Reckoner
(D) Referencer
- (h) The Consumer Service Audit critically examines _____
- (A) Outstanding payment of consumers
(B) The price consumers are ready to pay for a particular product/service.
(C) and appraises management of a business enterprise of responsibility towards consumers.
(D) Demand of a product by consumers.
- (i) Which of the following ratios appears as Profitability Ratio in Part D of Annexure to the Cost Audit Report ?
- (A) Net Profit to Net Sale
(B) Value added to Net Sales
(C) Profit before Tax to Value Added.
(D) Net Profit to Share Capital.
- (j) CAS 24 deals with _____.
- (A) Overburden Removal Cost
(B) Interest and Financing Charges.
(C) Royalty and Technical Knowhow Fee.
(D) Treatment of Revenue in Cost Statements

Answer : 1

- (a) (C) the Secretary and one Director of the company
Annexure to the Cost Audit Report in CRA 3 shall be approved by the Board of Directors and by signed by the Company Secretary and a Director authorized by the Board before submission to the Auditor for Report.
- (b) (C) factory overheads
As per CAS 8, the cost of self-generated utilities for own consumption shall comprise direct material cost, direct employee cost, direct expenses and factory overheads.
- (c) (C) 10 years
CAS 16 on depreciation and amortization states that useful life of an intangible asset shall not exceed 10 years from the date it is available for use.
- (d) (D) Part D
This is per Rule 6(4) of the Companies (Cost Records and Audit) Rules, 2014
- (e) (B) Cost Auditing Standard 102
CAS 102 deals with Cost Audit Documentation
- (f) (C) for a term exceeding 6 months
Part III of the Second Schedule to the Cost & Works Accountants of India Act, 1959 finds a member guilty of other misconduct if he/she is held guilty by a court for offences punishable with imprisonment for a term exceeding 6 months.

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- (g) (A) Dictionary
Cost Taxonomy is a Dictionary of all cost elements required in the Cost Audit Report and Compliance Report.
- (h) (C) and appraises management of a business enterprise of responsibility towards consumers.
Consumer Services Audit is an appraisal on the availability of a company's products to consumers in right quantity, right price, right place and right time.
- (i) (C) Profit before Tax to Value Added
This is one of the four ratios identified as Profitability Ratios in Part D of Annexure to the Cost Audit Report.
- (j) (D) Treatment of Revenue in Cost Statements
Effective from 1st April, 2017, CAS 24 on Treatment of Revenue in Cost Statements has become applicable.

Section- B (80 marks)

2. (a) (i) **While accepting the offer of appointment as Cost Auditor of a company, what certificate should be submitted by the Cost Auditor to the company ? Is the Cost Auditor required to give any certificate with respect to his/her/its independence and 'arm's length relationship' with the appointing company ?**
- (ii) **A company has units in SEZ and in non-SEZ areas. What would be the applicability of the Companies (Cost Records and Audit) Rules, 2014 on such a company with respect to maintenance of cost accounting records and Cost Audit ? (3+2)+3=8**
- (b) (i) **Mr. Arunmaya, a practicing Cost Accountant engaged two trainees, undergoing training under his guidance for audit job. Since the job was voluminous, he agreed to pay them, in addition to stipend, an amount of 10% of the audit fees. Does the action of Mr. Arumaya amount to professional misconduct ?**
- (ii) **State the ethical requirements of a Cost Auditor for ensuring the conduct of the audit of Cost Statements as per the Cost Auditing Standard 103. 4+4=8**

Answer : 2(a)(i)

The Cost Auditor appointed shall submit a certificate that –

- (a) The individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act (the Cost and Works Accountants Act, 1959) and the rules or regulations made thereunder ;
- (b) The individual or the firm, as the case may be satisfies the criteria provided in Section 141 of the Companies Act, 2013 so far as may be applicable ;
- (c) The proposed appointment is within the limits laid down by or under the authority of the Act ; and
- (d) The list of proceedings against The Cost Auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

Yes, the Cost Auditor of a company is required to give a certificate to the Audit Committee in respect of his/her/its independence and arm's length relationship with the company. Moreover, according to the Second Schedule, Part I, Clause 4 of the Cost and Works Accountants Act, 1959, it amounts to professional misconduct when a cost Auditor expresses his/her/its opinion on cost and pricing statement of any business or enterprise in which he/she, his/her firm or a partner of his/her firm has substantial interest.

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Answer : 2(a)(ii)

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

However, in view of the provisions of Rule 4(3) (ii) of the Companies (Cost Records and Audit) Rules, 2017, the units located in the special economic zone would be outside the purview of Cost Audit and the company would not be required to include particulars of such units in its Cost Audit Report. The other units of the company located outside the special economic zone would be covered under Cost Audit subject to the prescribed threshold limits.

Answer : 2(b)(i)

As per Part I of the First Schedule of the Cost and Works Accountants Act, 1959, a Cost Accountant in practice shall be deemed to be guilty of professional misconduct, if he/she pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his/her professional work, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner.

Under such circumstances, any payment to trainees as a percentage of audit fees is a professional misconduct. He may, if necessary, pay a lump sum stipend to the trainees.

Answer : 2(b)(ii)

The Application Guidance of Cost Auditing Standard 103 lays down that the Cost Auditor should comply with relevant ethical requirements as per the code of ethics issued by the Institute of Cost Accountants of India. This code establishes fundamental principles of professional ethics relevant to the Cost Auditor while conducting an audit and provides a conceptual framework for applying these principles. The fundamental principles which the Cost Auditor is required to comply with are given below.

- (a) Independence
- (b) Integrity
- (c) Objectivity
- (d) Professional Competence
- (e) Due Care
- (f) Confidentiality
- (g) Professional Conduct.

3. (a) (i) What items of expenses are to be included as Employee Cost as per the revised CAS 7 guidelines ?

(ii) What is the basis adopted to determine normal price with respect to related party transactions ?
4+4= 8

(b) The Financial Profit and Loss Account for the year 2017-18 of a company shows a net profit of Rs. 56,44,000.

During the course of Cost Audit, it was noticed that :

(i) The company was engaged in trading activity by sale of brads other than its own through its retail outlets and thus earned a profit of Rs. 2,85,000 during the year.

(ii) The claim on fire to the extent denied by the insurance company amounted to Rs. 3,50,000.

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- (iii) An amount of Rs. 6,00,000 was charged in the Cost Accounts an notional rent for the plant premises owned by the company.
- (iv) Interest received on inter-corporate deposits amounted to Rs. 5,60,000
- (v) VRS payment to the extend not amortized in the Financial Accounts amounted to Rs. 4,50,000.
- (vi) Unabsorbed assets value due to scrap of machine Rs. 4,10,000 was charged in the Financial Accounts and
- (vii) Stock valuation of finished and semi-finished goods was as given below.

	Financial Accounts Rs.	Cost Accounts Rs.
Opening Stock	27,79,000	29,56,200
Closing Stock	40,92,000	45,15,900

Work out the profit as per the Cost Accounts.

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Answer : 3(a)(i)

The revised CAS 7 Guidelines lay down that the following items of expenses are to be included in Employee Cost (for all employees whether temporary, part-time or contractual)

Employee Cost (payable in cash or kind excluding prior period costs)

- Salaries, wages, allowances, bonus/incentive
- Contribution to provident and other funds
- Employee welfare
- Other benefits.

Employee Cost (future benefits)

- Gratuity
- Leave encashment
- Other retirement/separation benefits
- VRS/other deferred employee cost
- Other future benefits.

Benefits generally include

- Paid holidays
- Leave with pay
- Statutory provisions for insurance against accident or health scheme
- Statutory provisions for workman's compensation
- Medical benefits to the employees and dependents.
- Free or subsidized food
- Free or subsidized housing
- Free or subsidized education to children
- Free or subsidized canteen, crèches and recreational facilities
- Free or subsidized conveyance
- Leave travel concession
- Interest-free or subsidized loans
- Any other free or subsidized facility
- Cost of employees' stock option

Answer :3(ii)

As per item 24 of CRA 1, normal price means price charged for comparable and similar products in the ordinary course of trade and commerce where the price charged in the sole consideration of sale and such sale is not made to a related party. Normal price can be construed to be a price at which two unrelated and non-desperate parties would

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agree to a transaction and where such transaction is not clouded due to the proximity of the parties to the transaction and free from influence though the parties may have shared interest. The basis adopted to determine normal price shall be classified as under :

- (i) Comparable uncontrolled price method
- (ii) Resale price method
- (iii) Cost plus method
- (iv) Profit split method
- (v) Transactional net margin method
- (vi) Any other method, to be specified.

Answer :3(b)

Reconciliation of Profit as per Cost Accounts with Profit as per Financial Accounts for the year 2017 - 18

	Amount Rs.	Amount Rs.
Profit as per Financial Accounts		56,44,000
Add :		
1) Loss on scrapping of machine	4,10,000	
2) Difference in Closing and Opening value of Stock in Cost Accounts (45,15,900 – 29,56,200)	15,59,700	
3) Insurance claim denied	3,50,000	
4) VRS expenses not amortized	4,50,000	
		(+) 27,69,700
Less :		
1) Trading Profit not included in Cost Accounts	2,85,000	
2) Interest from Inter-corporate Deposits	5,60,000	
3) Notional Rent Income provided in Cost Accounts	6,00,000	
4) Difference in Closing and Opening value of Stock in Financial Accounts (40,92,000 – 27,79,000)	13,13,000	(-) 27,58,000
Profit as per Cost Accounts		56,55,700

4. (a) Explain Management Audit and state its uses.

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(b)(i) You are appointed as the Energy Auditor of a medium-sized manufacturing company. Suggest some areas for conserving energy at the plant level.

(ii) Briefly discuss the concept of Proprietary Audit.4+4= 8

Answer:4(a)

Management Audit is the unique process appraising the performance of directors and managers or, in other words, appraising the performance of the management. In a number of organizations, Management Audit is now a regular feature to examine and improve managerial effectiveness. It is the systematic and dispassionate examination, analysis and appraisal of management's overall performance. It is a form of appraisal of the total performance of the management by means of an objective and comprehensive examination of the organization structure, its components, its plans and policies, its processes and controls and its use of physical facilities and human resources.

As per the CIMA, Management Audit is an objective and independent appraisal of the effectiveness of the managers and effectiveness of the corporate structure in the achievement of the company objectives and policies. Its aim is to identify existing and potential management weakness within an organization and to recommend ways to rectify these weaknesses.

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Uses of Management Audit

- (i) Management Audit is useful in synthesizing accounting, economic or other data required by the management in constructing the basic policy framework.
- (ii) It assists in establishing, reviewing and improving the planning system.
- (iii) It makes substantial contribution to the system of goal-setting in the organization.
- (iv) It ensures that management is getting adequate information for correct decisions.
- (v) It ensures that management properly uses the information that it is getting.
- (vi) It aids in the design and maintenance of adequate authority structure.
- (vii) It helps in improvement in the information system to expedite flow of information among responsibility centres.
- (viii) It substantially contributes for improvement of the entire communication system.
- (ix) It helps management in pinpointing key functions or operations in the profit-making process.
- (x) It helps management in establishing better criteria for measuring results.
- (xi) It helps management to avoid wasteful, unnecessary and extravagant use of resources.

Answer :4(b)(i)

Energy Audit means monitoring the energy efficiency of different equipment and processes in a plant and looking into ways by which the total sum of energy consumed can be cut down without affecting production or its efficiency. A few illustrations of possible sources for conserving energy are given below.

- (A) Steam generation & distribution: Selecting boilers to achieve fuel economy, evaluating the efficiency of steam generation, fixing up the cost of steam generation and improving the efficiency.
- (B) Steam utilization: Proper insulation, reducing hot water wastage, recycling hot air by economic means, and scheduling of processes/operations to achieve fuel economy.
- (C) Electrical energy utilization: Minimize maximum demand by tripping loads, use standby electric generation equipment for on-peak high load periods.
- (D) Installation of energy efficient system: Install (a) automatic control system, (b) thermal solar system for warm water, (c) temperature effective humidification.
- (E) Diesel exhaust recovery: Turning up diesel-generating sets for highest efficiency.

The list is illustrative and leaves scope for many areas for economic use.

Answer :4(b)(ii)

Propriety Audit stands for verification of transactions in the best interests of the public, commonly accepted customs and standards of conduct. The term 'propriety' has been defined by Kholer as 'that which meets the tests of public interest, commonly accepted customs and standards of conduct and particularly as applied to professional performance, requirements of Government regulations and professional codes'. The tests boil down to consideration of financial prudence and economy instead of too much dependence on documents, vouchers, etc. It shifts the emphasis to finding the appropriateness of expenditure, rather than verifying whether it has been duly authorized or evidenced by proper vouchers, etc.

In other words, Propriety Audit seeks to ensure that the planned expenditure would yield the optimum returns and there is no other better alternative available. It seeks to ensure that the expenditure is not only appropriate to the circumstances of each case but also has indeed achieved the objectives for which it has been incurred. The audit of public

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sector undertakings as undertaken by the Comptroller and Auditor General of India is an example of Propriety Audit.

5. (a) Write a note on the provisions relating to Internal Audit under the Companies Act, 2013. 8
(b) State the important steps to be taken in the internal audit of institutions providing Educational Services. 8

Answer :5(a)

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

Section 138

- (i) Such class or classes of companies as may be prescribed shall be required to appoint an internal auditor, who shall either be a Chartered Accountant or a Cost Accountant or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.
- (ii) The Central Government may, by Rules, prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board.

Rule 13 of the Companies (Accounts) Rules, 2014

The following class of companies shall be required to appoint an internal auditor or a firm of internal auditors, namely,

- (a) every listed company ,
- (b) every unlisted public company having –
- (i) paid up share wealth of rupees fifty crore or more during the preceding financial year, or
 - (ii) turnover of rupees two hundred crore or more during the preceding financial year, or
 - (iii) outstanding loans or borrowings from banks or public financial institutions exceeding rupees one hundred crore or more at any point of time during the preceding financial year, or
 - (iv) outstanding deposits of rupees twenty-five crore or more at any point of time during the preceding financial year, and
- (c) every private company having –
- (i) turnover of rupees two hundred crore or more during the preceding financial year, or
 - (ii) outstanding loans or borrowings from banks or public financial institutions exceeding rupees one hundred crore or more at any point of time during the preceding financial year.

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

Answer :5(b)

The important steps involved in the internal audit of an educational institution are stated below.

- (i) to examine the Trust Deed or Regulations of the educational institution and note all the provisions affecting accounts.
- (ii) to read through the minutes of the meetings of the Managing Committee or the Governing Body, noting the resolutions affecting accounts to see that those have been duly complied with
- (iii) to check names entered in the Students' Fees Register and test check the amount of fees charged and to verify that a system of internal check is in operation.

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- (iv) to check fees received by comparing counterfoils of receipts granted to confirm that the revenue from this source has been duly accounted for
- (v) to check admission fees, hostel caution money, etc., and confirm that the amount had been credited to a Capital Fund.
- (vi) to see that free studentships and concessions have been granted as per prescribed Rules.
- (vii) to confirm that hostel expenses were recovered before students' accounts were closed and their deposits of caution money refunded.
- (viii) to verify rental income from landed property with the rent rolls, etc., vouch income from endowments and legacies, as well as interest and dividends from investments and also inspect the securities in respect of investments held.
- (ix) to verify any government or local authority grant with the relevant papers of grant; if any expense has been disallowed for the purposes of grant, ascertain the reasons and compliance thereof.
- (x) to confirm that caution money and other deposits paid by students on admission have been shown as liability; investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.
- (xi) to verify that the Provident Fund money of the staff have been deposited with the appropriate authorities.
- (xii) to vouch donations, if any, and ensure that donations for any specific purpose were utilized for such purpose.
- (xiii) to vouch all capital expenditure in the usual way and verify the same with the sanction of the committee as contained in the minute book.
- (xiv) to vouch all establishment expenses and enquire into any unduly heavy expenditure under any head.
- (xv) to verify the inventories of furniture, stationery, clothing, provision and all equipment, etc.; these should be checked by reference to the Stock Register and values applied to various items should be test checked.
- (xvi) to confirm that the refund of taxes deducted from various incomes have been claimed and recovered since these institutions are generally exempted from the payment of income tax.
- (xvii) To verify the annual statements of accounts and, while doing so, see that separate statements of accounts have been prepared as regards specific Funds, viz., Poor Boys Fund, Games Fund, Hostel Fund, Provident Fund of staff. Etc.

6. (a) In a factory, running single shift, two products M and N, are manufactured.

	M	N
Man hours/unit	3	7
Production/month (units)	1,500	1,000

Month means 26 working days and 8 hours a day. The company employs 60 workers and the budgeted man-hours are 1,32,000 for the year. You are required to work out the (i) Capacity Ratio (ii) Activity Ratio and (iii) Efficiency Ratio. 8

(b) A chemical unit generates in-house power to meet its shortfall from grid supply. It has 20% surplus power which it can supply to the adjacent units. From the cost data given below, how would you compute the cost of power as per CAS 8 in the following circumstances ?

- (i) Power generated for the purpose of inter-unit transfers.**
- (ii) Power generated for the inter-company transfers.**

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Power generated		29,76,500 Kwh
Particulars	Total Amount (Rs.)	(Rs.)/'00 kwh
Coal Consumed less Ash Sale	15,80,000	53.08
Diesel Oil	1,85,000	6.22
Water	16,40,000	55.10
Stores	65,000	2.18
Salaries of Power House Staff	13,94,800	46.86
Repairs & Maintenance	2,96,000	9.94
Deprecation of Plant and Boiler	2,06,000	6.92
Share of Administration Overheads	2,05,000	6.89
Interest on Asset Purchase	1,40,000	4.70
Distribution Cost	1,80,000	6.05
Total Power House Cost	58,91,800	197.94

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Answer :6(a)

Budgeted man-hours for the year = 1,32,000

Budgeted man-hours for the month = 1,32,000/12 = 11,000 (maximum possible)

Actual man-hours hours worked = 26 × 8 × 60
= 12,480

Standard man-hours produced = 11,500

For Product P : 1500 × 3 = 4,500

For Product Q : 1000 × 7 = 7,000

(i) Capacity Ratio = Actual man-hours worked / Budgeted man-hours
= 12,480 / 11,000 = 113.45%

(ii) Activity Ratio = Actual production in Standard man-hours/ Budgeted man-hours
= 11,500 / 11,000 = 104.54%

(iii) Efficiency Ratio = Actual Production in Standard man-hours / Actual man-hours
= 11,500 / 12,480 = 92.15%

Activity Ratio = Capacity Ratio x Efficiency Ratio = 113.45% × 92.15% = 104.54%

Answer:6(b)

(i) Cost of power generated for the purpose of inter-unit transfers shall comprise direct material cost, direct employee cost, direct expenses, factory overheads and distribution cost. Interest on asset purchase and share of administration over heads will not form part of the cost. This is calculated as below :

Particulars	Total Amount (Rs.)
Coal Consumed less Ash Sale	15,80,000
Diesel Oil	1,85,000
Water	16,40,000
Stores	65,000
Salaries of Power House Staff	13,94,800
Repairs & Maintenance	2,96,000
Depreciation of Plant, Boiler	2,06,000
Distribution Cost	1,80,000
Total	55,46,800

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Therefore, cost of power generated for the purpose of inter-unit transfers
 = 55,46,800 / 29765 = Rs. 186.35 per 100 Kwh

- (ii) Cost of power generated for the inter-company transfers shall comprise direct material cost, direct employee cost, direct expenses, factory overheads, distribution cost and share of administrative overheads. Interest on asset purchase will not form part of the cost. This is calculated as below.

Particulars	Total Amount (Rs.)
Coal Consumed less Ash Sale	15,80,000
Diesel Oil	1,85,000
Water	16,40,000
Stores	65,000
Salaries of Power House Staff	13,94,800
Repairs & Maintenance	2,96,000
Depreciation of Plant, Boiler	2,06,000
Share of Administration Overheads	2,05,000
Distribution Cost	1,80,000
Total	57,51,800

Therefore, cost of power generated for the purpose of inter-company transfers
 = 57,51,800 / 29765 = Rs. 193.24 per 100 kwh

7. (a) From the following figures extracted from the financial and cost accounting records, you are required to compute :
- Value Added
 - Ratio of Operating Profit to Net Sales, and
 - Ratio of Operating Profit to Value Added.

Particulars	Rs. in lakh
Net sales excluding Excise Duty	50,400
Increase in Stock of Finished Goods	600
Expenses :	
Raw Materials Consumed	6,240
Packing Materials Consumed	2,880
Stores and Spares Consumed	1,344
Power and Fuel	11,040
Repairs and Maintenance	480
Insurance	288
Direct Salaries and Wages	1,152
Depreciation	2,124
Interest Paid	3,355
Factory Overheads :	
Salaries and Wages	576
Others	600
Selling and Distribution Expenses :	
Salaries and Wages	288
Additional Sales Tax	1,097
Others	4,080
Administration Expenses :	
Salaries and Wages	288
Others	192

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- (b) A unit actually operated 291 days in a year and was stopped for abnormal circumstances –

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- (i) 6 days due to power disruption for cyclone and flood, and
 (ii) 4 days due to heavy breakdown of core machinery.
 The rest of the days were weekly off or holidays. Half wages as lay-off compensation were paid for the stoppage period. During the year, total expenses incurred were
 (A) Salaries and wages (including lay-off compensation of Rs. 65 lakh) Rs. 3,360 lakh, and
 (B) Other fixed costs Rs. 1,050 lakh.

Find Abnormal Costs (in Rs. lakh)

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Answer :7(a)

- (i) Value Added = Rs. 23,856

	Rs. in lakh	Rs. in lakh
Computation of Value Added		
Sales + increase in Stock of Finished Goods		51,000
Less		
Cost of Materials and Services		
Raw materials consumed	6,240	
Packing materials consumed	2,880	
Stores and spares consumed	1,344	
Power and Fuel	11,040	
Repairs and maintenance	480	
Insurance	288	
Other Factory Overheads	600	
Other Selling and Distribution Expenses	4,080	
Other Administration Expenses	192	27,144
Value Added		23,856
(51,000 – 27,144)		
Composition of Value Added		
Depreciation	2,124	
Interest	3,355	
Additional Sales Tax	1,097	
Salaries and Wages (1,152+576+288+288)	2,304	8,880
Profit before Tax		14,976
Operating Profit		
Profit before Tax	14,976	
Interest paid	3,355	18,331

- (ii) Ratio of Operating Profit to Net Sales = $\frac{\text{Operating Profit}}{\text{Net Sales}} = \frac{18,331}{50,400} = 36.37\%$

- (iii) Ratio of Operating Profit to Value Added = $\frac{\text{Operating Profit}}{\text{Value Added}} = \frac{18,331}{23,856} = 76.84\%$

Answer :7(b)

As per Cost Accounting Standard on Material Cost (CAS- 6), any abnormal cost shall be excluded from material cost. So cost of abnormal events such as strike, lock out and other factors are not included in cost. The abnormal cost is estimated as below.

	Total Fixed Costs	Abnormal Costs
Working days	$291+6+4 = 301$	$6+4 = 10$
Salaries and Wages (Rs. in lakh)	3,360	65
Other Fixed cost (Rs. in lakh)	1,050	$= 1050 \times (10/301)$ $= 34.88$
Total	4,410	99.88

Out of total fixed costs of Rs. 4,410 lakhs, abnormal costs of Rs. 99.88 lakhs will not form part of cost of production.

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8. Answer any four questions.

- (a) Write a note on adjustment of cost variances in working out total cost.
- (b) How do you assess the adequacy of the Internal Audit function ?
- (c) How is the operational efficiency of a unit highlighted in the report by the Cost Auditor as per the Companies (Cost Records and Audit) Rules, 2014 ?
- (d) Fortune Textiles is using water for production and consumption purposes and raises water from a water body nearby and through recycling process. The water is treated through two processes and is transferred to the reservoir of the plant to supply for Boiler, Washroom, Humidification, Weaving, etc. A part of such water is transferred for human consumption in office, canteen and quarters through a branded Purifier. The initial water collection cost, inclusive of fees to local authorities, is. Rs. 1/kl and the other costs, including process waste, are shown below:

Particulars	Process 1	Process 2	Domestic
Water Raised (kl)	26,000	24,700	6,500
Water Transferred (kl)	24,700	23,400	6,500
Cost of Water Raised (Rs.)	Rs. 1/kl		
Processing Cost (Rs.)	57,460	39,700	15,000

Calculate the cost of water transferred from source to the Plant and the Domestic area.

- (e) The following figures relate to Walmart Street Ltd. for two years :

	31.3.2018	31.3.2017
Gross Profit%	30	25
Average Stock (Rs.)	45,000	60,000
Average Debtors (Rs.)	1,20,000	1,55,000
Stock Turnover (times)	20	25
Income Tax Rate (%)	30	30
Post-tax Income as % of Sales	8	9

Prepare Statement of Profits for two years.

4 × 4 = 16

Answer :8(a)

The guidelines laid down in CRA 1 state that 'Where the company maintains cost records on any basis, other than actual, such as Standard Costing, the records shall indicate the procedure followed by the company in working out the cost of the goods or services under such system. The cost variances shall be shown against separate heads and analysed into material, labour and overheads and further segregated into quantity, price and efficiency variances. The method followed for adjusting the cost variances in determining the actual cost of the goods or services shall be indicated clearly in the cost records. The reasons for the variances shall be duly explained in the cost records and statements.'

Answer :8(b)

Sometimes it is required to assess the adequacy of internal audit function of an organization. The questionnaire given below will help 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 ?

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7. Is there any internal audit manual ?
8. Is a programme of internal audit drawn up before the commencement of the financial year ?
9. Does the programme 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 ?

Answer :8(c)

- (1) The Cost Auditor has a report, as per CRA 3, whether the Cost Accounting System followed in a manufacturing unit is adequate for determination of the fair cost of production.
- (2) He/She/It 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.
- (3) He/She/it has to indicate the percentage of production in relation to the installed capacity expressed in appropriate units of measurement and also to state reasons for the shortfall in production, bringing out clearly the extent to which those are controllable both in the short-term and the long-term.
- (4) He/she/it 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 the previous year.
- (5) He/she/it has to give details of wages and salaries including direct labour cost per unit of output and as compared to the previous year.
- (6) He/she/it 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 to the previous two years.
- (7) The cost auditor has also to mention any abnormal features 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 improvement 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.

Answer :8(d)

Cost of Water transferred from source to Plant and Domestic area

Particulars	Process 1	Process 2	Domestic
A. Water Raised (KI)	26,000	24,700	6,500
B. Water Transferred (KI)	24,700	23,400	6,500
C. Cost of Water Raised (Rs.1/KI)	26,000	83,460	@5.26/KI=34,200 (approx)
D. Processing Cost (Rs.)	57,460	39,700	15,000

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E. Total Cost (Rs.) [C+D]	83,460	1,23,160	49,200
F. Unit Cost of Water Transferred (Rs.) [E÷B]	3.38/kl	5.26/kl	7.57/Kl

Answer :8(e)

Statement of Profits of Walmat Steel Ltd.

	31.3.2018	31.3.2017
a) Gross Profit %	30	25
b) Average Stock (Rs.)	45,000	60,000
c) Average Debtors (Rs.)	1,20,000	1,55,000
d) Stock Turnover (times)	20	25
e) Income Tax Rate (%)	30	30
f) Post-tax Income as % of Sales	8	9
g) Cost of Goods Sold (bxd)(Rs.)	9,00,000	15,00,000
h) Sales [g × 100 / (100-a)] (Rs.)	12,85,715	20,00,000
i) Net Income after Tax [hxf] (Rs.)	1,02,857	1,80,000
j) Profit before Tax [i × 100 / (100-e)] (Rs.)	1,46,939	2,57,143