

PAPER – 17 : COST AND MANAGEMENT AUDIT

SUGGESTED ANSWERS

SECTION – A

1.

- (i) (A)
- (ii) (D)
- (iii) (C)
- (iv) (B)
- (v) (A)
- (vi) (C)
- (vii) (C)
- (viii) (C)
- (ix) (D)
- (x) (A)
- (xi) (C)
- (xii) (C)
- (xiii) (B)
- (xiv) (C)
- (xv) (D)

SECTION – B

2. (a)

Benefits of Cost Audit:

The Expert committee formed by the Government of India to study the Cost Audit scenario in the country, highlighted the following benefits of cost information:

- (a) Cost information enables the organization to structure the cost, understand it and use it for communicating with the stakeholders.
- (b) Costing is an important tool in assessing organizational performance in terms of shareholder and stakeholder value. It informs how profits and value are created, and how efficiently and effectively operational processes transform input into output. It contributes to the data input on economy level parameters like resources efficiency, waste management, resources allocation policies, etc.
- (c) Costing includes product, process, and resource-related information covering the functions of the organization and its value chain. Costing information can be used to appraise actual performance in the context of implemented strategies.
- (d) Good practice in costing should support a range of both regular and non-routine decisions when designing products and services to:
 - meet customer expectations and profitability targets;
 - assist in continuous improvements in resources utilisation; and
 - guide product mix and investment decisions.
- (e) Working from a common data source (or a single set of sources) also helps to ensure that output reports for different audiences are reconcilable with each other.
- (f) Integrating databases and information systems can help to provide useful costing information more efficiently as well as reducing source data manipulation.

2. (b)

Para 18 of Form CRA 1 of CCRA Rules, 2014 states that Installed capacity is determined based on:

- (i) Manufacturers' Technical specifications
- (ii) Capacities of individual or inter-related production centres
- (iii) Operational constraints or capacity of critical machines or
- (iv) Number of shifts

Normal capacity shall be determined vis-a-vis installed capacity after carrying out following adjustments:

- (i) Holidays, normal shut down days and normal idle time,
- (ii) Normal time lost in batch change over,
- (iii) Time lost due to preventive maintenance and normal break downs of equipment's,
- (iv) Loss in efficiency due to ageing of the equipment, or
- (v) Number of shifts.

3. (a)

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

Remuneration of the Cost Auditor:

For the purpose of section 148(3)—

- (a) in the case of companies which are required to constitute an audit committee—
 - (i) the Board shall appoint an individual, who is a cost accountant in practice, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee, which shall also recommend remuneration for such cost auditor;
 - (ii) the remuneration recommended by the Audit Committee under (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;
- (b) in the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual, who is a cost accountant in practice or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.

3. (b)

Factors In Planning Cost Audit Assignment:

In planning the audit assignment, certain important factors are taken into consideration, viz.

- (a) Requirement of audit personnel for the assignment
- (b) Documentation of the audit procedures and of evidences
- (c) Quality control exercised over performance of the assignment, etc.

Audit personnel for the assignment

Experience and training of audit personnel engaged for the assignment should be considered particularly keeping in view the relevant industry. Prior practical experience of the industry helps in carrying out the study of the system and procedures in vogue. For this purpose, two pronged approaches may be adopted by the cost auditors. First, a study of the industry and the second, study of the Annual Reports of the auditee company for the past at least 5 years.

The cost audit team to whom the assignment is to be delegated need appropriate direction and supervision. It is therefore, essential that they accomplish the following tasks:

- (i) Physical inspection of the activities and the area where they are performed;
- (ii) Knowledge of the key personnel responsible for the activities and for the maintenance of cost records;
- (iii) Physical inspection of the cost accounting records and other records relating to activities;
- (iv) Study of the statements of budgets, plans and strategies relating to activities;
- (v) Study of the Cost Accounting system used and the basis according to relevant CAS.

The audit personnel should be asked to collect the documentary evidences for the above tasks and file in the relevant cost audit file for future reference.

Documentation of the audit procedures and of evidences

The cost auditor should document all matters which are important in providing evidence to support the opinion given in the report. Documentation means the working papers prepared by and for, or obtained and retained by the cost auditor in connection with the performance of the audit or compliance function. Working papers record the evidence resulting from the work performed, to support the cost auditors' opinion. It is important to remember that the documents may include issues beyond accounting data as other information such as production schedule, quantitative and statistical data, etc. may be required for preparation of performance analysis.

The daily worksheets should include all queries raised, with it was discussed and how, and if they were satisfied. Use of standardised working papers such as, checklists, confirmation forms, standard letters, etc. may improve the efficiency with which such working papers are prepared and reviewed. Schedules, statements, analyses and other documents prepared by the entity may be utilised and treated a part of the working papers, only after being satisfied that the materials have been properly prepared with due care.

Working paper management improves the productivity of the audit assignment undertaken. The essentiality is that of quick retrieval of information from the files of working papers. Working paper file contains details relating to the financial year under reference. This file should be properly indexed and divided into convenient sections.

The cost auditor and his team should adopt appropriate procedures for maintaining the confidentiality and safe custody of the working papers and for retaining them for a period sufficient to meet the needs of the practice and in accordance with legal and professional requirements of retention of records.

Quality control over performance of the assignment

Supervision and control involves direction, review and monitoring of the audit assignment in hand. The personnel carrying out these responsibilities generally perform the following functions during the course of audit.

- (a) Monitoring the progress of the preparation / maintenance of cost accounting records;
- (b) Reviewing that the audit assistants do have necessary skill and competence to understand the system and procedure to carry out the assigned tasks as per the overall plan;
- (c) Being aware of the cost accounting and auditing questions raised during carrying out of the assignment and assessing their significance and modifying the plan and programme, as considered necessary; and
- (d) Removing the differences of professional judgement between the personnel and deciding the level which is appropriate for reference purpose.

4. (a)

Value of Receipt of Material = ₹ 4,15,200

4(b):

Employees Cost of Steel Company Limited for the year 2022-23 = ₹ 2,675 (in lakh)

5. (a)

Profit as per Cost Accounts = ₹ 41,08,200

5. (b)

The forensic audit investigation is the utilization of specialized investigation skills to conduct the forensic audit engagements in such a manner that the outcome can be presented in a court of law as evidence. The auditor should use an approach considering both the aspects of

- i) whether the fraud could have occurred and
- ii) whether the fraud could not have occurred.

With this approach, the forensic auditors will be able to bring the reality closer to the general public, especially the circumstances where perception and reality are not aligned.

An auditor can follow a multi-step method for fact-finding in case of forensic audit engagements:

- Accept the forensic audit assignment. It is always useful to carry out a preliminary investigation prior to development of a detailed plan of action.
- Evaluate the allegations or suspicions. Set out the objectives to be achieved and Conduct due diligence background notes.
- Complete the preliminary stage of the investigation. The evidence should be sufficient to ultimately identify the fraudster, the mechanics of the fraud scheme, and the amount of financial loss suffered.
- Check the prediction assuming that there will be litigation.
 - i. Begin with an external investigation.
 - ii. Gathering the required proofs and evidence.
 - iii. Preparing report on findings.

6. (a)

- i. The Cost Auditor has to report in CRA 3, whether the Cost Accounting System followed in a manufacturing unit 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.

Management by exception

- a) 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.
- b) 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.
- c) He has to give details of wages and salaries including direct labor cost per unit of output and as compared to the previous year.
- d) 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.

Remedial Actions:

In this case the following position emerges: 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.

6. (b)

Cyber Security:

Cyber Security is a professional discipline that is about creating defensive measures to protect against cyber attacks. People working in this industry may have a wide range of information technology (IT) skills including programming, operating systems and networking. The primary goal of any cyber security professional is to create a network or system that is impossible to breach, thereby protecting the information within the network.

One important note about cyber security is that it is almost entirely about prevention. Even more niche positions like ethical hackers, only use their offensive skills to test networks and improve them.

Cyber Security encompasses many protocols that are used in the real world. Things like setting user permissions, establishing file transfer protocols (FTPs) and requiring secure, frequently changing passwords are all vital elements of cyber security. It is not just up to one individual, everyone in an organisation needs to practice safe computer usage for security to be maintained.

Computer Forensics:

Computer Forensics is the practice of recovering data from a device, often to uncover evidence of criminal activity. The practice itself is reactionary, meaning that it only takes place after an incident has occurred and is not concerned with preventing the incident itself.

Computer forensics jobs typically serve one of two purposes. They either assist with an investigation or help people and companies recover data that has been lost. In the first instance, a computer forensics specialist will be given access to a suspect's device, such as laptop, desktop, or smartphone. Once they have the device, they begin using a variety of skills, such as programming, hardware knowledge, and software knowledge, to locate valuable data. In a law enforcement case, they will ideally uncover data that is of value to the prosecution and can be presented in a court of law. To do this, the data must be recovered in a very particular manner that does not violate the suspect's rights.

Sometimes, computer forensics specialists are called in to help a company recover lost data. While the purpose of the assignment differs greatly from uncovering evidence of criminal activities, the processes used to recover the lost data are very similar. The main difference in the execution of these tasks is that the particular processes required to create court-admissible evidence do not need to be followed in this case. In some cases, if the data is lost as a result of cybercrime, the computer forensics expert may be tasked with recovering the data and identifying the perpetrator of the crime.

Cyber Security v/s. Computer Forensics:

Cyber security is focused on prevention, while computer forensics is about recovery and reaction. Despite the differences, both are meant to protect data, programs, networks and other digital assets. Cyber security helps to prevent cybercrimes from happening, while computer forensics helps recover data when an attack does occur and also helps identify the culprit behind the crime.

It helps to think of cyber security professionals as a security company and to think of computer forensics experts as investigators.

7. (a)

- (i) Net Profit Margin = 10.46%
- (ii) Return on Assets = 9.10%
- (iii) Return on Equity = 18.20%
- (iv) Asset Turnover = 0.87 Times
- (v) Inventory Turnover = 33.33%

7. (b)

Evaluation of Personnel Development:

The best, most loyal employees are often people who started near the bottom of the organisational chart and worked their way up the ladder with the help, support, and encouragement of their manager/employer. That help, support, and encouragement are all part of employee development. In a well-managed company, there are systems in place to provide appropriate development opportunities and resources. In addition, managers are trained to support their team members with coaching, meaningful feedback, and in some cases-mentorship.

Managers have an important role to play in ensuring development of people. Some of the most important things a manager can do for their team members are:

- Delegating responsibility rather than fixing problems before they arise.
- Honest and candid feedback for the development
- Offering or suggesting specific appropriate development opportunities to employees
- Motivating for additional risk and reward.
- Demonstrating the meaning of true LEADERSHIP attributes (L.E.A.D.E.R.S.H.I.P. – Loyalty, Empathy, Accountability, Determination and Dutifulness, Encouragement, Respect, Selfless, Humble, Integrity and Innovation, Passion)

Formal Employee Development Strategies:

- A. Imparting general and specific training. Training on development of “Soft skills” (interpersonal communication, public speaking, negotiation, leadership skills, etc.) will improve ability of the people aspiring for self-growth.
- B. Psychometric studies to understand mentality to function in leadership roles, often also resorted to assess.

Informal Employee Development Strategies:

In addition to formal employee development, many corporations offer informal development options. These often take the form of on-the-job training, shadowing, mentorship, or similar experiences that allow newer employees to learn from seniors. In addition, managers may choose to coach promising employees to prepare them for more challenging roles.

Performance Evaluation:

Most companies conduct annual performance evaluations of employees against the task assigned in their Key Result Area.

The ‘goal setting exercise’ determines the role and assignment of broad areas. Periodical review exercise is carried out to evaluate and track the shortfall in achievement. Any mid-term intervention or changes also can be given effect based on the requirement. Annual review (performance appraisal) is a agglomeration of earlier period/s of the appraisal period. The basic objective is to provide feedback to employees for their role and organisational requirement.

- Rating Scales allow managers to rate the quality of an employee’s performance or skills based on numerical values, wherein minimum and maximum is specified. Actual ratings given and accepted by employee placed normally in a ‘bell curve’ to identify top performers out of the total population.
- 360⁰ Feedback mechanism perused in progressive Organisations where employees’ managers, subordinates, and peers to provide feedback about performance of the employee from every angle. This can be a very useful form of evaluation, as some individuals can be wonderful managers, but have a difficult time interacting with peers or vice versa. By gathering a wide range of perspectives, managers can pinpoint areas of strength and opportunities for growth. On the other hand, this

approach can be problematic, if the employee in question is less popular for any reason, or if a supervisee is unhappy about being disciplined.

Management by Objectives is a personalized evaluation technique that measures the individual employee's achievement by comparing the employee to objectives agreed upon the prior year. For example, the employee and manager may have agreed on a particular sales objective, at the end of the year, the employee's actual sales can be compared positively or negatively to the individualized objective.

8. (a)

Necessity of Internal Audit

- i.** Internal Audit assists management to improve internal controls by identifying weaknesses in systems and provides an opportunity to correct those weaknesses. Internal auditors deal with issues that are important to the continued existence and prosperity of any organisation.
- ii.** It helps to detect errors and frauds and provides suggestions to rectify the same and to pre-empt possibility of recurrence.
- iii.** It steps in time to detect the misuse of resources, which helps to reduce infructuous unnecessary expenses.
- iv.** It helps in improving the processes and workflow. It also works as a morale check.
- v.** The Internal audit checks the books of accounts, detects errors and frauds and helps in its correction which makes the act of External/Statutory Auditor easier. He can rely on the internal audit reports and reduce the audit time.
- vi.** The vigil by Internal Audit team and timely intervention, keeps operating staff on their toes for keeping Books updated.
- vii.** Independent review of operations/business.

8. (b)

The special steps involved in the audit of an educational institution include a variety of conventional and special type of audit of documents:

Examination of basic Constitution of the Institution:

- (i) Documents relating to formation of the institution, affiliation, Management structure, Governing Body, ownership, etc. requires due attention for fund monitoring, donation, spent approval process, affiliation fees payment, etc.
- (ii) Examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.
- (iii) Approving authority for expense, fund transfer, bank account operation, etc. Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts.
- (iv) To see that these have been duly complied with, especially the decisions as regards the operation of bank accounts and sanctioning of expenditure.

For examination data relating to students:

- (a) Semester / Class-wise Student Register with details of Student name, address, Aadhar No./Card, Guardian details, Contact No., etc. and fee structure (full fees, half fees, sanctioned waiver, etc.) mapped for ensuring accuracy of collection.

- (b)** Where collection through direct Banking takes place, the Bank Statement to be equated with 'fees receivable/ recoverable' for completeness check and proper revenue /collection (advance/ arrear) recognition.
 - (c)** Fees collected and Fees Book counterfoil reconciliation also can be carried out for fees collected at the Counter. Collection against every student, whose names are appearing in the 'Student Register' to be validated and unpaid ones to be followed-up.
 - (d)** Updation of 'Student Register' w.r.t discontinued, transferred students, drop-outs, etc. to be carried out on timely basis.
 - (e)** Fees condonation by appropriate authority to be considered for reconciliation between receivable fees and received.
 - (f)** Admission and other collections (late fees, transfer charges etc.) need to be tracked for separately and booked under appropriate Account Heads.
 - (g)** Confirm that hostel dues were recovered before students' accounts were closed and their caution deposits appropriately adjusted/refunded.
 - (h)** Verify other sources of income (rental income from landed property with the rent rolls, bank Fixed Deposit interest from Deposit Certificates, etc.)
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