PAPER - 17: COST AND MANAGEMENT AUDIT

SUGGESTED ANSWERS

SECTION-A

1. (a)

(i)	(D)
(ii)	(D)
(iii)	(C)
(iv)	(B)
(v)	(D)
(vi)	(C)
(vii)	(D)
(viii)	(D)
(ix)	(A)
(x)	(B)

1. (b)

(xi)	(C)
(xii)	(A)
(xiii)	(A)
(xiv)	(D)
(xv)	(A)

SECTION – B

2. (a)

ADVANTAGES OF COST ACCOUNTING STANDARDS:

Cost Accounting Standards are set of standards that are designed to achieve uniformity and consistency in cost accounting principles and practices.

The Cost Accounting Standards:

- Provide a structured approach to measurement of costs in manufacturing process or service industry;
- Integrate, harmonize, and standardize cost accounting principles and practices;
- Provide guidance to users to achieve uniformity and consistency in classification, measurement, assignment, and allocation of costs to products or services;
- Arrive at the basis of computing the cost of product, activity, or service where required by legal or regulatory bodies;
- Enable practicing members to make use of Cost Accounting Standards in the attestation of General Purpose Cost Statements; and
- Assist in clear and uniform understanding of all the related issues of various user organisations, government bodies, regulators, research agencies and academic institutions.

2. (b)

APPLICABILITY FOR COST AUDIT:

(1) Every company specified in item (A) of rule 3 shall get its cost records audited in accordance with these rules, if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is rupees fifty 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 twenty five crore or more.

(2) Every company specified in item (B) of rule 3 shall get its cost records audited in accordance with these rules, 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.

(3) 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, exceeds seventy five per cent of its total revenue; or

(ii) which is operating from a special economic zone;

(iii) which is engaged in generation of electricity for captive consumption through Captive Generating Plant. For this purpose, the term "Captive Generating Plant" shall have the same meaning as assigned in rule 3 of the Electricity Rules, 2005.

3. (a)

QUALIFICATIONS:

Applicability of Section 141 of the Companies Act,2013, with respect to the Qualification of Cost Auditor, to be read along with Section 148 of the Companies Act, 2013, Cost and Works Accountants Act, 1959 and Companies (Cost Records and Audit) Rules, 2014

Section 148(5) of the Companies Act, 2013, inter alia provides that qualifications as applicable to auditor (financial) is also applicable to cost auditor, so far as may be applicable.

In view of what is stated above, Qualification of Cost Auditor are enumerated as given below:

1) A person shall be eligible for appointment as cost auditor who is a cost accountant (Section 148(3))
2) Cost Accountant means a Cost Accountant as defined in clause (b) of sub-section (1) of Section 2 of the Cost and Works Accountants Act,1959 and who holds a valid certificate of practice under sub-section(1) of Section 6 of the Cost and Works Accountants Act,1959 (Section 2(28))
3) "Cost Accountant" means a person who is a member of the Institute (Clause (b) of sub-section (1) of Section 2 of Cost and Works Accountants Act, 1959.
4) A person is a member of the Institute, if his name appears in the Register of the Institute (Subsection (2) of Section 19 of Cost and Works Act, 1959
5) An Individual or Firm, as the case may be is eligible for appointment as cost auditor provided he/it satisfies the criteria as provided in section 141 of the Act (Sub Section (b) of Section (1A) of Rule 6 of Companies (Cost Records and Audit) Rules, 2014.
6) Proviso to subsection (1) of Section 141 provides that a firm can also be appointed by its firm name as cost auditor of the company, if majority of its partners practising in India are qualified for appointments as cost auditors of the company.
7) Sub-Section (2) of Section 141 provides that where a firm including a limited liability partnership (LLP) is appointed as Cost Auditor of the company, only the partners who are cost accountants shall be authorized to act and sign on behalf of the firm.

DISQUALIFICATIONS:

As per Section 141(3), read with Rule 10 of Company (Audit and Auditor) Rule 2014 and Section 148, the following persons shall not be eligible for appointment as Cost Auditor of a company:

(a) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;

(b) an officer or employee of the company;

(c) a person who is a partner, or who is in the employment, of an officer or employee of the company;

(d) a person who, or his relative or partner:

(i) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company, of face value not exceeding rupees one lakh;

(ii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of rupees five lakh;

(iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of rupees one lakh

(e) a person or a firm who, whether directly or indirectly, has business relationship with the Company, or its subsidiary, or its holding or associate company or subsidiary of such holding company of such nature as may be prescribed;

(f) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel.

(g) a person who is in full time employment elsewhere or a person or partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;

(h) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;

(i) a person who, directly or indirectly, renders any service referred to in Section 144 to the company or its holding company or its subsidiary company.

3. (b)

In a Cost Audit program, draw a checklist to audit the production of a manufacturing unit-

- The audit assignment should be planned with professional care. It has to provide reasonable assurance that the cost information provided is free of material misstatements. As regards the audit of production- product-wise, the following checklist may be considered.
- Ensure that there is proper inventory balancing for each of the finished products. Viz. (op stock+ production = sales+ closing stock.)
- The closing stock of the previous year is correctly considered in the opening stock of the current year.
- Check the capacity utilization of 5 years' product-wise.
- For any abnormal underutilization of production capacity, the auditor should seek the reasons and enquire into the steps the management proposes to overcome it.

Alternatively,

For any abnormal underutilisation of production capacity the auditor should seek the reasons from the management and what steps management has proposed to undertake to overcome underutilisation of capacity. Underutilisation of capacity should merit attention and focus where either product is profitable or the product has substantial positive contribution.

- Check whether there are any circumstances where there is an addition to capacity for any product during the year but the increase is not reflected in the records.

Alternatively,

Check whether there is any circumstance where there is addition to capacity for any product during the year but actual production achieved is either equal to or less than that of previous year. Reasons for the same should be sought from the management.

- An MIS for five years in prescribed form be submitted.

4. (a)

(i)

(a) Rated Capacity = 90 MT/ Hr

Rated Capacity achieved in 2023-24: (70/90) X 100 =77.78%

Rated Capacity achieved in 2022-23: (80/90) X 100 =88.89%

The capacity achievement as % of rated capacity has declined from 88.89% to 77.78% in 2023-24

Further the capacity utilisation has gone down to 59.49% in 2023-24 from 75.63% of previous year, a reduction of 16.14%.

(b) **From the data available the following observations are noted:**

1. Breakdown hours have gone up from 1,230 to 2,388 hours an increase by 94.15%
2. Planned Maintenance hours has reduced from 482 hours to 258 hours that is by 46.47%
3. Shortfall hours due to lack of orders has decreased from 878 to 822 hours i.e by 6.38%
4. The total stoppage hours has increased from 5,120 to 5,348 hours i.e. by 4.45%
5. The total running hours has come down from 3,971 to 3,570 hours i.e. by 10.10%
6. The production has come down from 3,17,650 MT to 2,49,865 MT i.e. by 21.34%

From the above findings, it can be pointed out that the underutilization of capacity can be attributed mainly to:

(i) Increased total stoppage hours and

(ii) the net increase of stoppage hours is again due to increase of breakdown hours

(ii) Suggestions:

Therefore, the company should look into the aspect of proper maintenance, securing sufficient orders to avoid that time. Better utilization of capacity can be also be achieved by improving availability of wagons. The company may also carry out a cost-benefit analysis to have captive source of power.

4. (b)

The following items will not be included according to CAS -7:

(i) VRS paid for closure of a unit

(ii) Abnormal cost charges to Profit and Loss account

(iii) Arrears salary not related to the current year

(iv) Compensation paid against past periods

(v) Wages paid to contractor employees

As per Explanation (1) of CAS-7 under Para 4.7, Contract employees directly engaged by the employer on contract basis but does not include employees of any contractor engaged in the organisation.

Employees Cost:	**₹ in lakhs**
Salary and Wages	825
Contribution to Provident Fund	100
Employees Welfare	45
Bonus	120
Total	1,090

5. (a)

Value Addition **(₹in lakh)**

The year ended 31st March	**2024**	**2023**
Revenue from Operations + GST	10,324	8,773
Less: GST	510	440
Net Revenue from Operations	9,814	8,333
Export Incentives	116	103
Increase in stock of finished goods	235	182
Total	10,165	8,618
Less: cost of bought-out inputs		
Materials consumed	5,278	4,473
Stores and spares	348	287
Power & Fuel	522	450
Others (Prime Overheads)	247	221
Total cost of bought-out inputs	6,395	5,431
Value Added	3,770	3,187

5. (b)

Code of Ethics for Certified Fraud Examiners:

1. A Certified Fraud Examiner shall, at all times, demonstrate a commitment to professionalism and diligence in the performance of his or her duties.
2. A certified Fraud Examiner shall not engage in any illegal or unethical conduct or any activity which would constitute a conflict of interest
3. A Certified Fraud Examiner shall, at all times, exhibit the highest level of integrity in the performance of all professional assignments, and will accept only assignments for which there is a reasonable expectation that the assignment will be completed with professional competence.
4. A Certified Fraud Examiner will comply with lawful orders of the courts, and will testify to matters truthfully and without bias or prejudice.
5. A Certified Fraud Examiner, in conducting examinations, will obtain evidence or other documentation to establish a reasonable basis for any opinion rendered. No opinion shall be expressed regarding the guilt or innocence of any person or party.
6. A Certified Fraud Examiner, shall not reveal any confidential information obtained during a professional engagement without proper authorization
7. A Certified Fraud Examiner shall reveal all material matters discovered during an examination, which, if omitted, could cause a disorder.
8. A Certified Fraud Examiner shall continuously strive to increase the competence and effectiveness of professional services performed under his or her direction.

6. (a)

CUSTOMER DUE DILIGENCE:

Financial institutions should be prohibited from keeping anonymous accounts or accounts in fictitious names. Financial institutions should be required to undertake customer due diligence (CDD) measures when:

(i) Establishing business relations
(ii) Carrying out occasional transactions above the applicable designated threshold (USD/EUR 15,000); or
(iii) There is a suspicion of money laundering or terrorist financing; or
(iv) The financial institution has doubts about the veracity or adequacy of previously obtained customer identification data.

The principle that financial institutions should conduct CDD should be set out in law. Each country may determine how it imposes specific CDD obligations, either through law or enforceable means.

The CDD measures to be taken are as follows:

(a) Identifying the customer and verifying that customer's identity using reliable, independent source documents, data or information.
(b) Identifying the beneficial owner, and taking reasonable measures to verify the identity of the beneficial owner, such that the financial institution is satisfied that it knows who the beneficial owner is. For legal persons and arrangements, this should include financial institutions understanding the ownership and control structure of the customer.
(c) Understanding and, as appropriate, obtaining information on the purpose and intended nature of the business relationship.
(d) Conducting on going due diligence on the business relationship and scrutiny of transactions are undertaken throughout that relationship to ensure that the transactions being conducted are consistent with the institution's knowledge of the customer, their business, and risk profile, including, where necessary, the source of funds.

Financial institutions should be required to apply each of the CDD measures under (a) to (d) above but should determine the extent of such measures using a risk-based approach (RBA) by the Interpretive Notes to this Recommendation.

Financial institutions should be required to verify the identity of the customer and beneficial owner before or during establishing a business relationship or conducting transactions for occasional customers. Countries may permit financial institutions to complete the verification as soon as reasonably practicable following the establishment of the relationship, where the money laundering and terrorist financing risks are effectively managed, and where this is essential not to interrupt the normal conduct of business.

Where the financial institution is unable to comply with the applicable requirements under paragraphs (a) to (d) above (subject to appropriate modification of the extent of the measures on a risk-based approach) it should be required not to open the account, commence business relations or perform the transaction, or should be required to terminate the business relationship, and should consider making a suspicious transactions report about the customer.

These requirements should apply to all new customers, although financial institutions should also apply this Recommendation to existing customers based on materiality and risk, and should conduct due diligence on such existing relationships at appropriate times.

Record-Keeping:
Financial institutions should be required to maintain, for at least 5 years, all necessary records on transactions, both domestic and international, to enable them to comply swiftly with information requests from competent authorities. Such records must be sufficient to permit the reconstruction of individual transactions (including the amounts and types of currency involved, if any) to provide, if necessary, evidence for the prosecution of criminal activity.

Financial institutions should be required to keep all records obtained through CDD measures (e.g. copies or records of official identification documents like passports, identity cards, driving licenses, or similar documents), account files, and business correspondence, including the results of any analysis undertaken (e.g., inquiries to establish the background and purpose of complex, unusual large transactions), for at least five years after the business relationship is ended, or after the date of the occasional transaction.

Financial institutions should be required by law to maintain records on transactions and information obtained through the CDD measures.

The CDD information and the transaction records should be available to domestic competent authorities upon appropriate authority.

6. (b)
CORPORATE SOCIAL RESPONSIBILITY (CSR) AUDIT:
Corporate Social Responsibility can be understood as the initiative of a company to assess and take responsibility for the environment and impact on social welfare. Corporate social responsibility is a form of corporate self-regulation integrated into a business model. CSR policy functions as a built-in, self-regulating mechanism whereby a business monitors and ensures its active compliance with the spirit of the law, ethical standards, and international norms.
The goal of CSR is to embrace responsibility for the company's activities and encourage a positive impact through its activities on the environment, consumers, employees, communities, stakeholders, and all other members of the public sphere who may also be considered as stakeholders.

All types of CSR information disclosure are effected by the need for credibility. Some examples are:

1. Employees, to provide confidence in systems, establish progress against targets and improve confidence;
2. Specialists, including analysts, particularly rating agencies, government officials, and NGOs;
3. Business partners, to strengthen the supply chain; and
4. Communities, to establish credibility with neighbours and local organisations.

Internal Auditors might be involved in CSR at various levels:

(i) Internal Auditors might facilitate or advise management on CSR self-assessment activities.
(ii) Internal Auditors might be involved in auditing CSR programs, either as individual components of the audit plan, or as a broad-based review of how CSR is managed, and whether the company is achieving its CSR objectives.
(iii) Internal Auditors might become involved in co-ordinating or participating in CSR Report verifications.
(iv) Proposed expenditure is made in areas demarcated/specified.

Internal Auditors have an opportunity to make value additions to the Corporate Sustainability Reporting process of their organisation. They must have a good knowledge and understanding of prevalent CSR concepts. Important role internal auditors can play includes:

- (i) Assist in the design/implementation of the CSR management system
- (ii) Perform limited scope audits requested by top management
- (iii) Perform compliance audits.

7. (a)

Maintenance of Data Integrity:

Data Integrity includes the safeguarding of the information against unauthorized addition, deletion, modification or alteration. This includes items such as accounting records, backup, documentation, etc. Information Systems are used to capture, store, process, retrieve and transmit the data securely and efficiently. The emphasis is on the accuracy of the data and its transmission in a secured manner. Data Integrity also implies that during the various phases of electronic processing, various features of the data viz. Accuracy, Confidentiality, Completeness, Up-to-date status, Reliability, Availability, Timeliness and Effectiveness are not compromised. In other words, data should remain accurate during electronic processing.

The desired features of the data are described hereunder:

- (a) Accuracy: Data should be accurate. Inaccurate data may lead to wrong decisions and thereby, hindering the business development process.
- (b) Confidentiality: Information should not lose its confidentiality. It should be protected from being read or copied by anyone who is not authorised to do so. It also includes protecting the individual pieces of information that may seem harmless by the owner but can be used to infer other confidential information.
- (c) Completeness: Data should be complete. Incomplete data loses its significance and importance.
- (d) Up-to-date Status: Data should be updated regularly. If the information is not up-to-date, it presents a false picture of the organisation.
- (e) Reliability: Data should be reliable because all business decisions are taken based on the current database.
- (f) Availability: Data should be available when an authorized user needs it. It should be ensured that the information services are unavailable to unauthorized users.
- (g) Timeliness: Timeliness of the data is very important because if data is not available when required, the very purpose of maintaining the database gets defeated.
- (h) Effectiveness: Information should be effective so that it helps in the process of business development and expansion.

If data integrity is not maintained, an organisation loses its true representation. Poor data integrity could lead to the loss of competitive advantage. The corruption of data would affect many users in a networked environment. If the data is valuable to a competitor, its loss may undermine an organisation's competitive position.

7. (b)

Four essential dimensions involved in Corporate Development Audit:

- (i) Regularity: That means the different elements/parts of a body corporate are under constant watch.
- (ii) Systematic Check: This suggests the assessment of changing requirements of a corporate body in the context of forces generated from within and outside.

- (iii) Review: This assesses past performance, its quality, and content, and its contribution to the corporate goals as definitively pronounced from time to time. This examines the deviations from goal realisation and suggests measures for achievement.

- (iv) Appraisal: This examines in detail the character, content and quality of the corporate goals set matches the resources employed against the attainments recorded, and suggests the Future course of action on the premise that nothing is taken for granted even goals.

Scope of Corporate Development Audit:

The scope of corporate development audit can be viewed from both Micro and Macro level:

1. **Corporate Planning and Policy:**
   Planning is an exercise undertaken on a long-term basis even before the forecast are drawn up. It requires examining the business enterprise and its whole environment in greater detail from the viewpoints of potential strengths and weaknesses. The possible audit areas are planning and policy issues on the product, production, finance, personnel, managerial-particularly 'succession' etc.

2. **Corporate Forecasting:**
   Forecasts are usually medium-term and commonly short-term. The thrust of the audit is to ascertain by a review process.

(a) The degree of co-relationship that exists between corporate plans and total industry plans.
(b) The competitive market share position within that industry.
(c) The factors for forecasts, such as supply and demand, industry trends, enterprise's competitive performance, general economic and political trends, financial standing about the competitors, etc.
(d) How well the corporate forecasts match with national economic development plans.

3. **Corporate Strategy:**
   For a long-term strategy, the auditor attempts to assess whether a corporate sector will survive as a viable entity. For short-term strategies, the auditor examines and evaluates how a firm analyses its on-going strategy-the strategy of operations on existing lines.

Four broad dimensions are usually covered in any strategic audit, viz:

(a) Product lines and basic competitive position
(b) R & D and operating departments
(c) Financial analysis and financial management, and
(d) Top management for each dimension, past achievements, present attainments, and future potential for each area are considered.

4. **Corporate Externalities:**
   Certain elements external to a corporate firm have impacts on its policies and decisions. The audit, in this respect, seeks to evaluate the factors, such as economic environment, industry structure and corporate position, risk of technological obsolescence, socio-politico-cultural environment, etc. which affect the growth and development of an enterprise.

5. **Corporate Internalities:**
   The areas covered are organisation development, management development, personnel development, and their detailed sub-systems- which provide internal strengths or weaknesses to a corporation.

8. (a)

Preparation for Operational Audit:

There are two kinds of approaches Active and Passive approach in all types of assignments and especially for Operational Audit for a paradigm shift to 'beyond compliance'. The active zone of 'operational audit' is to prevent 'wasteful activities' with a view 'to reduce revenue leakages and cost'. This in turn having a positive impact on business performance.

The contemporary approaches of 'Risk Based Audit' are not in total sync with 'Operational Audit'. Risk pertaining to 'Operations" is prioritized for 'Risk Based Audit' and recommended mitigation, fails to provide a holistic coverage for the entire gamut of risk associated with the 'Operation' and improvement in 'value chain' through a set of corrective measures.

Objectives:

Operational Audit objective has been coined here after the name of connoisseur of TQM (Total Quality Management) W.E. Deming. To define the objective the word 'DEMING' is used, where each of the word stands for a definitive objective accomplishment.

D – Detailed understanding for existing process to suggest improvement
E – Eliminate Waste, Duplication of work
M –Merge Operations/Processes to reduce Turn Around Time
I- Improve/Increase Quality, Volume, Revenue
N – New Methods, Techniques, Devices for better result/throughput
G – Govern Man, Machine, Methods and Money

To carry out the heightened expectations of 'stakeholders' on their shoulder, Auditors can no longer spend their time looking down at financial controls and compliances rather to spend much more time in operation reviews.

To support the accomplishment of aforesaid objective, the audit process to tend appropriate support. Process provides a methodology for intelligently and efficiently integrating People, Tools, Procedures and Technology for the best results/outcome.

8. (b)

AUDIT OF HOSPITALS:

The following points are to be considered necessary for conducting an audit of Hospital.

(i) Check the letter of appointment to ascertain the scope of responsibilities
(ii) Ownership and control of the institution
(iii) Process (e.g. admission, release, outdoor check-up, pathology and other test facilities, Operation Theatre facility, vaccination etc.) and related controls till revenue generation. Normally facilities not provided for other than cash terms.
(iv) Donation, Special Grant, Interest and/or dividend income etc. to be validated through necessary supporting documents should be vouched with a reference to the Investment Register and Interest and Dividend Warrants.
(v) Ensure purposive donations, grants etc. spent for the particular purpose only.
(vi) Clear distinction should be made between the items of capital and revenue nature.
(vii) Adherence to Standard Operating Procedure w.r.t. Expenses (Capex and Opex)
(viii) Verify the system of internal check as regards purchases and issue of stores, medicines, medical equipment etc.
(ix) Examine that the appointment of the staff, visiting specialist doctors, payment of salaries etc. for expenditure booking validation.
(x) Physically verify the investments, fixed assets and inventories
(xi) Check appropriateness of capitalization and depreciation rates charged and value in Books.