

FINAL EXAMINATION

GROUP IV

(SYLLABUS 2008)

SUGGESTED ANSWERS TO QUESTIONS

JUNE 2014

Paper- 17 : COST AUDIT & OPERATIONAL AUDIT

Time Allowed : 3 Hours

Full Marks : 100

The figures in the margin on the right side indicate full marks.

- Please: (1) Answer all bits of a question at one place.
(2) Open a new page for answer to a new question.
(3) Attempt the required number of questions only.
Working notes should form part of the answer.

Whenever necessary, suitable assumptions should be made and indicated in answer by the candidate.

**Section A (50 Marks)
(Cost Audit)**

Answer Question No. 1 (carrying 14 marks) which is compulsory and Answer any two (carrying 18 marks each) from the rest in this Section.

1. (a) In each of the cases/statements given below, one out of four alternatives is correct. Indicate the correct answer (only indicate A or B or C or D as you think correct.) 1x8
- (i) XBRL (Extensible Business Reporting Language) is a language based on
 - A. XML family of languages
 - B. XRL family of languages
 - C. XBL family of languages
 - D. None of the above
 - (ii) PARA 6 of the Annexure to Cost Audit report under the Companies (Cost Audit Report) Rules 2011 deals with
 - A. Product group details
 - B. Quantitative information of each product group separately
 - C. Operating ratio analysis for each product group separately
 - D. Abridged Cost Statement for each product group separately
 - (iii) Financial Position and Ratio Analysis under PARA 9 of the Annexure to Cost Audit Report under Companies (Cost Audit Report) Rules 2011 is to be furnished for
 - A. Current year only
 - B. Current year and previous 2 years
 - C. Current year and previous year
 - D. Current year and previous 3 years
 - (iv) As per CAS-8 cost of utilities shall not include
 - A. Employee cost
 - B. Administrative overheads
 - C. Imputed costs
 - D. Selling overheads

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- (v) Cost Accounting Standard on Cost of Service Cost Centers is dealt in
A. CAS 9
B. CAS 10
C. CAS 11
D. CAS 13
- (vi) Maximum amount of Penalty payable by a Cost Auditor for non-compliance with Provisions of the Companies (Cost Audit Report) Rules 2011 is
A. ₹ 1,000
B. ₹ 5,000
C. ₹ 10,000
D. ₹ 15,000
- (vii) Warranty Costs and after sales Service Costs are part of selling overheads as per_____. (Fill in the gap from the below)
A. CAS 12
B. CAS 14
C. CAS 15
D. CAS 17
- (viii) Electricity is a part of power and under the head of utilities but it is also a Raw material in
A. Cement Plant
B. Caustic Soda Plant
C. Steel Plant
D. None of (A), (B), (C)
- (b) State whether the following statements based on the quoted terms are TRUE or FALSE with justifications for your answer. No credit will be given for any answer without justifications: 1x6
- (i) Interest and financial charges are considered to be a part of Cost of production.
- (ii) Form A XBRL (Extensible Business Reporting Language) is used for filing COST AUDIT Report of a Company.
- (iii) Financial position and Ratio Analysis are being dealt with PARA-3 of Annexure to Cost Audit Report under Companies (Cost Audit Report) Rules 2011.
- (iv) As per CAS-6 the Forex Component of imported material is converted at the rate on date of payment.
- (v) Cost Accounting Standard on Direct Expenses is dealt in CAS-11.
- (vi) Cost Audit is to be conducted only when the shareholders of the Company direct such an audit at the Annual General Meeting.

Answer:

1. (a) (i) (A)- XML family of languages
(ii) (C)- Operating ratio analysis for each product group separately
(iii) (B) - Current year and previous 2 years
(iv) (C)- Imputed costs
(v) (D) - CAS 13
(vi) (B)- ₹ 5,000
(vii) (C)- CAS 15
(viii) (B) - Caustic Soda Plant
- (b) (i) **False:** As per CAS 4 interest and financial charges being financial charges are not considered to be a part of cost of production.
- (ii) **False:** Form A - XBRL (Extensible Business Reporting Language) is used for filing Compliance Report of a Company.
- (iii) **False:** Financial position and ratio analysis are being dealt with Para 9 of the Annexure to cost Audit Report under Companies (Cost Audit Report) Rules-2011.

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- (iv) **False:** As per CAS-6 the Forex component of imported material is converted at the rate on date of transaction.
- (v) **False:** The Cost Accounting standard on Direct Expenses is dealt in CAS-10.
- (vi) **False:** Cost Audit is conducted when Central Government directs/approves such an audit.

2. (a) The following figures are extracted from the Accounts of SINJINI LTD., a single product Manufacturing Company:

BALANCE SHEET AS AT MARCH 31

	2014	2013	2012
	(Amount in ₹ lakhs)		
LIABILITIES:			
Share Capital	1,500	1,000	1,000
Reserves and Surplus	2,180	1,625	1,220
Secured Loans:			
Term Loans	1,540	825	750
Debentures	800	800	800
Unsecured Loans:	600	750	700
Current Liabilities & Provisions:			
Current Liabilities	1,330	626	860
Provisions	400	300	250
TOTAL	8,350	5,926	5,580
ASSETS:			
Fixed Assets:			
Gross Block	4,255	3,824	3,520
Less: Depreciation	2,222	1,920	1,720
	2,033	1,904	1,800
Capital Work-in-Progress	852	-	-
Net Block	2,885	1,904	1,800
Investments in Subsidiaries	400	200	200
Current Assets, Loans & Advances:			
Inventories	2,015	1,245	1,160
Sundry Debtors	2,405	1,650	1,520
Cash and Bank Balances	305	202	380
Loans & Advances	340	725	520
TOTAL	8,350	5,926	5,580

Profit and Loss Account for the year ended March 31, 2014

	2014	2013
	(Amount in ₹ lakhs)	
INCOME:		
Sales (including Excise duty)	14,520	12,255
EXPENDITURE:		
Material Consumed	5,670	4,504
Excise duty on despatches	3,345	3,426
Employee Costs	825	690
Other Manufacturing expenses	550	480
Selling and distribution expenses	1,551	1,401
Administration expenses	250	230
Interest on:		
Term Loans	346	201

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Debtures	120	120
Others	80	100
Depreciation	302	200
Difference in stock	826	268
	13865	11620
Profit Before Taxation (PBT)	655	635
Provisions for Taxation	100	230
Profit After Taxation (PAT)	555	405
Transferred to Balance Sheet		

You are required to compute the following figures/ratios as stipulated in PARA-9 of the Annexure to Cost Audit Report under Companies (Cost Audit Report) Rules 2011 for the year ended March 31, 2013 and 2014.

- (i) Capital Employed
- (ii) Net Worth
- (iii) Net Sales
- (iv) PBT to Capital Employed
- (v) PBT to Net Worth
- (vi) PBT to Net Sales
- (vii) Current Assets to Current liabilities
- (viii) Debt-Equity Ratio

$$3+2+2+2+2+(1 \times 5)=16$$

- (b) Specify the factors to be considered while estimating the useful life of a depreciable asset as laid down in CAS-16. 2

Answer: 2(a)

SINJINI LTD.					
		2014		2013	
		Amount (₹ Lakhs)	Amount (₹ Lakhs)	Amount (₹ Lakhs)	Amount (₹ Lakhs)
(i)	CALCULATION OF CAPITAL EMPLOYED				
	(Average of Opening & Closing Net Tangible Assets)				
	Opening Balance of Net Tangible assets	1,904.00		1,800.00	
	Closing Balance of Net Tangible Assets (Excluding capital work-in-progress)	2,033.00		1,904.00	
	Average Net Tangible Assets		1,968.50		1,852.00
	Add: Average of Opening & Closing Net Current Assets				
	(Average of Opening & Closing Net Current Assets - Current Liabilities)				
	Opening Current Assets	3,822.00		3,580.00	
	Less: Opening Current Liabilities	926.00		1110.00	
	Opening Net Current Assets (A)	2,896.00		2,470.00	
	Closing Current Assets	5,065.00		3,822.00	
	Less: Closing Current Liabilities	1,730.00		926.00	
	Closing Net Current Assets (B)	3,335.00		2,896.00	
	Average of Opening & Closing Net Current Assets (A +B)/2		3,115.50		2,683.00
	CAPITAL EMPLOYED		5,084.00		4,535.00
(ii)	CALCULATION OF NET WORTH				
	Share Capital	1,500.00		1,000.00	
	Reserves	2,180.00		1,625.00	
	NET WORTH		3,680.00		2,625.00

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(iii)	CALCULATION OF NET SALES				
	Sales (including Excise Duty)	14,520.00		12,255.00	
	Less: Excise Duty	3,345.00		3,426.00	
	NET SALES		11,175.00	8,829.00	
	Profit Before Tax (PBT) (given)		655.00	635.00	
	Current Assets:				
	Inventories	2,015.00		1,245.00	
	Sundry Debtors	2,405.00		1,650.00	
	Cash & Bank balances	305.00		202.00	
	Loans & Advances	340.00		725.00	
			5,065.00	3,822.00	
	Current Liabilities:				
	Current Liabilities	1,330.00		626.00	
	Provisions	400.00		300.00	
			1,730.00	926.00	
	Debt:				
	Secured Loans	1,540.00		825.00	
	Term Loans	800.00		800.00	
	Unsecured Loans	600.00		750.00	
			2,940	2,375	
(iv)	PBT to Capital Employed	655/5,084	12.88%	635/4535	14.00%
(v)	PBT to Net Worth	655/3,680	17.80%	635/2625	24.19%
(vi)	PBT to Net Sales	655/11175	5.86%	635/8829	7.19%
(vii)	Current Assets to Current Liabilities	5065/1730	292.77%	3822/926	412.74%
(viii)	Debt to Equity Ratio	2940/3680	79.89%	2375/2625	90.47%

(b) While estimating the useful life of a depreciable asset, consideration shall be given to the following factors:

- (i) Expected physical wear and tear;
- (ii) Obsolescence; and
- (iii) Legal or other limits on the use of the asset

3. (a) How would you compute the cost of UTILITIES as per CAS-8 in the following circumstances?

- (i) Utilities generated for the purpose of Inter Unit transfer.**
- (ii) Utilities generated for the purpose of Inter Company transfer.**
- (iii) Utilities generated for the Sale to outside parties.**

2x3=6

(b) The extracts of Trial Balance pertaining to AMRIT LTD., a manufacturing company as on March 31, 2014 is given below:

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(Amount in ₹ thousand)

Particulars	Amount (₹)	Particulars	Amount (₹)
Material Consumed	3,000	Special Subsidy received from Government towards Employee Salary	340
Salaries	1,800		
Employee Training Cost	250		
Perquisites to Employees	540		
Contribution to Gratuity Fund	480		
Lease rent to accommodation provided to employees	360	Recoverable Amount from Employee out of perquisites extended	50
Festival Bonus	60		
Unamortized amount to Employee Cost related to a discontinued operation	110		

Required:

Compute the Employee Cost for the year ended March 31, 2014 - keeping in view of the relevant Cost Accounting Standard (CAS-7). 6

(c) What information is required to be furnished by the Cost Auditor in the Annexure to the "Cost Audit Report" and "Observations and Suggestion" in regard to exports, if any of the product under Audit? 6

Answer:

3. (a) (i) Cost of utilities generated for the purpose of inter unit transfers shall comprise of direct material cost, direct employee cost, direct expenses, factory overheads and the distribution cost incurred for such transfers.
- (ii) Cost of utilities generated for the inter company transfers shall comprise of direct material cost, direct employee cost, direct expenses, factory overheads, distribution cost and share of administrative overheads. Transmission loss should be treated as per agreement between the parties.
- (iii) Cost of utilities generated for the sale to outside parties shall comprise of direct material cost, direct employee cost, direct expenses, factory overheads, distribution cost, share of administrative overheads and marketing overheads. The sale value of such utilities will also include the margin, and share of research and development cost incurred for development and improvement of existing process or product.

(b)

Computation of Employee Cost for the year ended March, 31 2014(as per CAS-7)

(Amount in ₹ thousand)

Particulars	Amount (₹)
Salaries	1800
Add: Perquisite to employees	540
Less: Recoverable from Employee	<u>50</u>
Add: Lease rent for accommodation provided to employees	360
Add: Festival Bonus	60
Add: Contribution to Gratuity Fund	480
	3,190
Less: Special subsidy received from Government towards Employee cost	(340)
Employee Cost:	2,850

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Note: Employee cost is aggregate of all kinds of considerations paid should not included Imputed /Notional cost. Subsidy, grant, incentives received shall be reduced for ascertainment of cost of this cost object.

- (c) Every cost auditor, who conducts an audit of the records of a company, is required to submit his report by electronic mode along with his observations and suggestions, if any, and annexure to the Central Government in the form prescribed in the Rules. A copy of the report along with Annexure is also required to be forwarded to the company at the same time. The rules have prescribed Form I, Form II and Form III in respect of cost audit reports.

Under Annexure of the Form II, cost auditor furnished the following information relating to export are as follows:-

- (i) **Para 4:** In para 4, while declaring the Actual sales, Export Sale (manufacturing) and export sale (trading), if any is to be declared.
- (ii) **Para 8:** In para 8 export incentives are to be shown and added to net sales.
- (iii) **Para 10:** In para 10, the related party disclosures are to be made
- (iv) **Para 11:** In para 11, reconciliation of Indirect taxes, for computation of Total clearance, exports are to be considered

4. (a) **SHRIZONI LTD., a single product manufacturing company, has following four operations undergone by a product under Cost Audit.**

The Process wise Input, Output, Direct Employee Costs and Direct Material Costs for the year ended March 31, 2014 are given below:

Process	Input Unit	Output Unit	Direct Employee Cost of the process (₹)	Direct Material Cost of the process (₹)
AM	62,400	56,160	1,68,480	2,24,640
BN	66,000	59,500	2,38,000	2,67,750
CP	82,800	79,500	3,97,500	3,37,875
DQ	78,000	72,200	5,77,600	4,76,520

You are required to calculate:

- (i) **Direct Employee Cost per unit of the product.**
- (ii) **Direct Material Cost per unit of the product,—under reference as required in PARA-5 of the Annexure to Cost Audit Report under Companies (Cost Audit Report) Rules 2011. (2+2+2+2)=8**
- (b) **PARA-9 of the Annexure to Cost Audit Report under the Companies (Cost Audit Report) Rules 2011 requires disclosure of "Cost of Production" and "Cost of Sales" at a Company level. How the same would be available when all the products/activities are not cover under Cost Audit? 3**
- (c) **How would you treat demurrage charges as per CAS-15? 2**
- (d) **The following details of the process-wise Wastages on Inputs are taken from the Cost Accounting Records of MAHAVIN COTTON MILLS LTD. a yarn manufacturing company, for the year ended march 31, 2014:**

PROCESS	% of Wastage on Input
Mixing and Blow Room	8.82
Carding	6.91
Drawing	1.24
Roving (Simplex)	1.15
Ring frame (Spinning)	7.04
Winding	1.75

Required:

Calculate the Process-wise "WASTE MULTIPLIER" factors for the year ended March 31, 2014. 5

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Answer:

4. (a)

Total employee cost per unit and total material cost per unit of the product under Audit must be an aggregation of process wise employee costs and material costs after taking into account the good units occurring in each process.

SHRIZONI LTD.			
Process	Input (unit)	Output (unit)	Factor
AM	62,400	56,160	$62,400/56,160 = 1.1111$
BN	66,000	59,500	$66,000/59,500 = 1.1092$
CP	82,800	79,500	$82,800/79,500 = 1.0415$
DQ	78,000	72,200	$78,000/72,200 = 1.0803$

(A) Process wise Employee costs per unit of output (Product) are:

AM: $168480/56160 = ₹ 3$

BN: $238000/59500 = ₹ 4$

CP: $397500/79500 = ₹ 5$

DQ: $5776008/72200 = ₹ 8$

(B) Process wise material cost per unit of output/product are:

$224640/56160 = ₹ 4.00$

$267750/59500 = ₹ 4.50$

$337875/79500 = ₹ 4.25$

$476520/72200 = ₹ 6.60$

(i) Aggregating all above (A), employee costs to the finished product from process DQ will be:

Process AM = ₹ 3.0000

Process BN = ₹ $3 \times 1.1092 + 4 = ₹ 7.3276$

Process CP = ₹ $7.3276 \times 1.0415 + 5 = ₹ 12.6317$

Process DQ = ₹ $12.6317 \times 1.0803 + 8 = ₹ 21.6460$

Direct employees cost per unit of finished product (Output) is ₹ 21.65

(ii) Aggregating all above (B), material costs to the finished product from process DQ will be:

Process AM = ₹ 4.0000

Process BN = ₹ $4.00 \times 1.1092 + 4.50 = ₹ 8.9368$

Process CP = ₹ $8.9368 \times 1.0415 + 4.25 = ₹ 13.5577$

Process DQ = ₹ $13.5577 \times 1.0803 + 6.60 = ₹ 21.2464$

Hence, Direct material cost per unit of finished product (Output) is ₹ 21.25.

(b) The Companies (Cost Accounting Records) Rules 2011 [CARR] is now applicable to all companies engaged in production, processing, manufacturing and mining. Hence, product-wise/ activity-wise cost of production and cost of sales would be available from the Cost Accounting Records of all the product activities, irrespective of whether these are covered under cost audit or not.

It may further be noted that in such a situation, the company would also be required to file a compliance report and for this purpose, product-wise/ activity-wise cost of production and cost of sales would be determined to prepare the reconciliation statement as required in the compliance report.

(c) 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 selling and distribution overhead.

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(d)

MAHAVIN COTTON MILLS LTD.

Calculation of 'Waste Multiplier' factors for the year ended March 31, 2014

Process	%age of Wastages on input	Net output for 100 units of input	Waste multiplier
TOTAL		100.00	1.3212
Mixing and Blow room	8.82	(100-8.82) =91.18	1.2047
Carding	6.91	91.18-(91.18x0.0691) =84.88	1.1214
Drawing	1.24	84.88-(84.88x0.0124) =83.83	1.1075
Roving (Simplex)	1.15	83.83-(83.83x0.0115) =82.87	1.0949
Ring frame (spinning)	7.04	82.87-(82.87x0.0704) =77.04	1.0178
Winding	1.75	77.04 -(77.04x0.0175) =75.69	1.0000

Working Notes:

- 1) Mixing & Blow Room = 100-8.82 = 91.18
 Carding = 91.18-(91.18x0.0691) = 91.18-6.30 = 84.88
 Drawing = 84.88-(84.88x0.0124) = 84.88-1.05 = 83.83 etc

2) **Waste Multiplier:**

- 100/75.69 = 1.3212 83.83/75.69 = 1.1075
 91.18/75.69 = 1.2047 82.87/75.69 = 1.0949 etc.
 84.88/75.69 = 1.1214

Section B (50 Marks) (Operational Audit)

Answer Question No. 5 (carrying 14 marks) which is compulsory and Answer any two (carrying 18 marks each) from the rest in this Section.

5. (a) State whether the following statements based on the quoted terms are "TRUE" or "FALSE" with justifications for your answer. No credit will be given for any answer without justifications. 1x5=5
- (i) Operational Audit is a micro level Management Audit.
 - (ii) The Secretariat of the WTO will be headed by a Secretary.
 - (iii) Interest Cost should be included in inventory valuation for purposes of Bank Audit.
 - (iv) "Position Analysis" is one of the Techniques used by the Management Auditor for valuation of Corporate image.
 - (v) GATT and its agreement are permanent.
- (b) Fill in the blanks in the following sentences by using appropriate word(s)/phrase(s)/number(s): 1x6=6
- (i) Professionally managed organization uses _____ in deciding and determining increments, promotions and other rewards for their employees.
 - (ii) Energy Audit means the monitoring of energy efficiency of different ____ and ____ in a plant.
 - (iii) "_____ is to know best that has been said and thought in the world"- Mathew Arnold.
 - (iv) "Management Audit" can be a ____ for managerial control and reduction of cost.
 - (v) _____ Corporate image of a company is built up not only by its product quality, but also, by its attitude towards various _____ .
 - (vi) _____ is the evaluation of every resources declared in Industry.

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- (c) Define the following terms (in not more than two sentences): 1x3=3
- (i) Sun Set Clause
 - (ii) Green Room Meetings
 - (iii) Corporate Branding

Answer:

5. (a) (i) **True:** It is audit of the performance at mainly operating level i.e. supervisory level. It is also termed as micro level management audit.
- (ii) **False:** The Secretariat of the WTO will be headed by a Director-General.
- (iii) **False:** Interest cost is finance cost and to be excluded for valuation Inventories.
- (iv) **True:** Position Analysis is one of the techniques used by the Management Auditor for valuation of corporate image.
- (v) **False:** GATT and its agreement are ad hoc and provisional.
- (b) (i) Performance Appraisal systems
- (ii) Equipment, process
- (iii) Culture
- (iv) Potent tool
- (v) Stakeholders
- (vi) Productivity Analysis
- (c) (i) **Sun Set Clause:** A sun set clause or provision is part of a law or statute that can repeal the law or parts of it at a specified time period. Such clauses are specifically directed at keeping constant reviews of restrictive measures like Anti-dumping, countervailing measures.
- (ii) **Green Room meetings:** The "Green Room" is a phrase taken from the informal name of WTO's director- General's conference room. These meetings help in initiating informal meeting within the WTO (World Trade Organization).
- (iii) **Corporate Branding:** Corporate Branding is the process of creating and manufacturing a favourable reputation of the company and its constituent elements. It is an important organizational resource that enables to create, strengthen and sustain competitive advantage.
6. (a) What are the basic differences between "Management Audit" and "Operational Audit"? 5
- (b) 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 techniques available to the Management Auditor to evaluate the Corporate Image. 4+4=8
- (c) State the Role of the Audit Committee. 5

Answer:

6. (a) The basic differences between "Management Audit" and "Operational Audit" are enumerated below:

Particulars	Operational audit	Management audit
Definition	Review and appraisal of operations of an organization carried on by a competent independent person.	The Audit of the Management focuses on evaluating Managers' ability to manage.

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Areas covered	Operational Areas where standards and actual performance defined and expressed in quantitative terms are considered.	It is concerned with appraising <ul style="list-style-type: none"> • Management's accomplishment of organizational objectives, • Management functions of planning, organizing, directing, and controlling, and • Adequacy of Management's Decisions and action in moving towards its objectives.
Focus	Focus is on efficiency and economy in operations.	Focus is on effectiveness of Management decisions and actions.
Standards	Expectations or standards are expressed in quantitative terms, for comparison of actual therewith	Standards are not defined in quantitative or monetary terms,
Evaluation	It is objective in nature, since standards are quantifiable.	Evaluation is comparatively subjective, since standards are not defined in monetary terms.
Technical background	Operational Auditor should have a strong technical and operational background.	Management Auditor should have conceptual background. Technical background desirable but not compulsory

(b) The approaches to be made by the management auditor to evaluate the corporate image of the company are as follows:-

- (i) He should prepare a list of desirable attributes.
- (i) The attributes should be classified into main groups and each group dovetailing the specific qualifications.
- (ii) 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.

The techniques available to the management auditor for evaluating the corporate image are as follows:-

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

(c) Role of Audit Committee

The role of the Audit Committee shall include the following:

- (i) Oversight of the company's financial reporting process and the disclosure of its

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financial information to ensure that the financial statement is correct, sufficient and credible.

- (ii) Recommending to the Board, the appointment, re-appointment and if required, the replacement or removal of the statutory auditor and the fixation of audit fees.
- (iii) Approval of payment to statutory auditors for any other services rendered by the statutory auditors.
- (iv) Reviewing with the management, the annual financial statements before submission to the Board for approval.
- (v) Reviewing, with the management, performance of statutory and internal auditors, and adequacy of the internal control systems. Reviewing the adequacy of the internal audit function.
- (vi) Reviewing the findings of any internal investigations, where there is suspected fraud or irregularity.
- (vii) Post-audit discussion with statutory auditors.
- (viii) To look into the reasons for substantial defaults in the payment to the depositors, debenture holders and creditors.
- (ix) Carrying out any other function, as mentioned in the terms of reference of the Audit Committee.

7. (a) You are the Management Auditor of SITERAZE LTD., a large manufacturing company suffering from WORKING CAPITAL Crunch. What are the related Areas which you would probe into to overcome the Company's problem? 10

(b) What do you understand by "Energy Audit"? Briefly state the key functions of Energy Auditor. 3+5=8

Answer:

7. (a) Adequate working capital is required for liquidity and smooth operations of the company. To ensure on adequate flow of working capital to the manufacturing company, the following action plan may be considered:
- (i) **Working Capital Estimation:** The company should start by preparing a statement of the projected working capital requirements. This should be based on the functional budgets in sales, production, expenses, capital expenditure and the Master Budget consisting of projected profit and loss and the Balance Sheet.
 - (ii) **Cash flow statement/cash budget:** Month-wise cash budgets showing inflows and outflows of cash head-wise should be prepared to analyse the major inflows and outflows affecting the entity. At this stage any wasteful outflow can be traced and eliminated. Bank reconciliation should be undertaken periodically so that outstanding can be traced and acted upon. This is also necessary to reduce the float time.
 - (iii) **Inventory/stock Management:** Raw materials and inventories should be classified properly to determine the level of stock of materials. The method of costing also needs to be looked at minutely. There is a need to establish linkage with the production pattern and work backwards accounting for time factor in receipt of material. This needs to be worked out carefully since at no cost, production schedule should be hampered. The cautions also need to be exercised that there is no unused/obsolete inventory. The system of inventory management needs to be looked at so as to check the avoidable wastes/scrap generated during storage and handling. Just in time philosophy will enable the company to reduce processing time, stocks and related costs. The adoption of such a mechanism would bring down the cost to a considerable extent.
 - (iv) **Credit Management:** The company should lay down a proper policy for evaluating customers, determining the credit period and offering discounts for early payment. An age-wise analysis of debtors should also be prepared so as to avoid credit to defaulters. The sale departments need to be geared up so that realization can be

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made in time. A careful analysis should be done of various customers according to pattern of sales so as to exercise control on their respective debit balances. The company should through its purchase department endeavor to avail the maximum credit period from its creditors. This would enhance the working capital of the company.

- (v) **Fund Flow Analysis:** The company should prepare a funds flow analysis, distinguishing between long-term and short-term sources and applications.
- (vi) **Investment Management:** The idle funds of the company, if any, should be invested in short-term securities to augment the income.
- (vii) **WIP Analysis:** Minimum WIP should be monitored and for the purpose it is necessary to ensure that no bottlenecks developed at any stage during the production process.

(b) Energy Audit is the key to a systematic approach for decision-making in the area of energy management. It attempts to balance the total energy inputs with its use, and serves to identify all the energy streams in a facility. It quantifies energy usage according to its discrete functions.

Industrial Energy Audit is an effective tool in defining and pursuing comprehensive energy Management programme.

As per the energy Conservation Act, 2001, Energy Audit is defined as "the verification, monitoring and analysis of use of energy including submission of technical report containing recommendations for improving energy efficiency with cost benefit analysis and an action plan to reduce energy consumption".

In that context, energy Management involves the basic approaches reducing avoidable losses, improving the effectiveness of energy use and increasing energy use efficiency. The function of an energy auditor could be compared with that of a financial Auditor. The Energy Auditor is normally expected to give recommendations on efficiency improvements leading to monetary benefits and also advise on energy management issues. Generally energy auditor for the industry is an external party.

The following are some of the key functions of the Energy Auditor:

- (i) Quantification of energy costs and quantities.
- (ii) To devise energy database formats to depict to correct picture-By product, department or consumer.
- (iii) To correlate trends of production or activity to energy cost.

While performing the aforesaid key functions, the energy auditor is required to carry out the following activities:

- (i) To analyse the historical energy consumption and cost data.
- (ii) To conduct preliminary energy audit with the objectives to identify:
 - (a) major energy consuming equipment and process;
 - (b) obvious inefficiencies and energy wastes ; and
 - (c) priority areas for further detailed investigation ,
- (iii) To conduct detailed technical and economic analysis of energy efficiency measures involving large efficiency measures involving large capital investment or long payback periods.

8. Write short notes on any three out of the following:

6x3=18

- (a) Disclosure and transparency of Corporate Governance**
- (b) Functions of the WTO (World Trade Organization)**
- (c) Corporate Services Audit**
- (d) Quality Review Board**

Answer:

8. (a) Disclosure and Transparency of Corporate Governance:

Disclosure and transparency of Corporate Governance include the followings;

1. Disclosure should include, but not be limited to, material information on:
 - (a) The financial and operating results of the company.
 - (b) Company objectives.
 - (c) Members, of the board and key-executives and their remuneration.
 - (d) Material foreseeable factors.
 - (e) Material issues regarding employees and other stakeholders.
 - (f) Governance structures and policies.
2. Information should be prepared, audited and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure and audit.
3. An annual audit should be conducted by an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented.
4. Channels for disseminating information should provide for fair, timely and cost efficient access to relevant information by users.

(b) Functions of the WTO (World Trade Organization):

The world trade organization is the main organ of implementation of the Multilateral Trade Agreements (MTAs). After World Bank and IMF, this is the third biggest international organization in Finance and Trade matters. The main functions of WTO are as follows:-

- (i) Facilitate the management of the MTAs and the plurilateral trade Agreements for fulfillment of their obligations.
- (ii) All Multilateral Trade Relations concerning the above agreements will be negotiated by the Members in this forum.
- (iii) WTO will also facilitate implementation of the results of the negotiations as decided by the Ministerial Conference.
- (iv) The WTO shall administer the understanding on Rules and Procedures Governing the Settlement of Disputes, forming part of the Agreements (MTAs and PTAs).
- (v) The WTO is responsible for administration of the Trade Policy Review Mechanism (TPRM) forming part of the Agreement.
- (vi) WTO is also the organ for establishing co-ordination with other Wings of the UNO such as the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD) and its affiliated agencies.

(c) Corporate Services Audit:

The term "Corporate Services" is a generic term, which implies service oriented obligations of a corporate body to different interested 'Public' such as consumers, shareholders, community, fellow-businessmen, government etc. It includes the social responsiveness of a business enterprise.

Corporate Services Audit is the audit of social behaviour of the company to assess the extent to which the company had met the expectations of the customers, employees, shareholders, suppliers and the community.

The scope of the Corporate Services Audit extends to the critical examination of the different aspects of services and the extent to which the corporate body has rendered satisfactory services. It also includes the evaluation of the degrees of responsiveness and awareness on the part of such enterprise. The performance of the management towards customers, employees, shareholders, suppliers, the community and government is studied separately and properly evaluated by management auditor.

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The areas of Corporate Service Audit and the scrutiny and evaluation criteria can be categorized as follows:

Consumers: Quality of goods in right quantity, right price, right place and right time.

Employees: Pay, Safety, Welfare etc.

Shareholders: Safety of investment, capital appreciation.

Community: Social cost, public relation.

Fellow-Businessmen: Business ethics and fair trade dealings.

State: Payment of taxes, fair trade practices etc.

(d) Quality Review Board:

There has been growing demand for high quality assurance, consistency and greater transparency in functioning of profession. So, Board for Quality Review has set up, named, "Quality Review Board" and incorporated in the Cost and Works Accountants Act, 1959 which would contribute to public confidence in the integrity and enhancing the quality of work done by the members of the Institute. U/S 29A of Cost and Works Accountants Act, 1959, "Quality Review Board" constitute a Chairperson and four other members of which two members shall be nominated by the council and other two members shall be nominated by the Central Government. U/S 29-B of the Act relates to the functions of the Board which are as follows:

- (i) To make recommendation to the council with regard to quality of services provided by members of the institute;
- (ii) To guide the members of the institute to improve the quality services, provided by the members of the Institute including cost advisor services and
- (iii) To review the quality and adherence to the various statutory and other regulatory requirements.