

FINAL EXAMINATION GROUP IV (SYLLABUS 2012)

SUGGESTED ANSWERS TO QUESTIONS JUNE 2014

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.

The paper is divided in three sections.

From Section A answer any Four questions ($4 \times 15 = 60$ marks)

From Section B, answer any Two questions ($2 \times 10 = 20$ marks)

From Section C answer any Two questions ($2 \times 10 = 20$ marks)

Working Notes should form part of the answer.

"Wherever necessary, suitable assumptions may be made and indicated in answer by the candidates."

Section A (60 marks)

Answer any Four questions.

$15 \times 4 = 60$

1. (a) From the following particulars make out a monthly cost sheet of Coke Oven Company Limited for the Financial Year ended 31.03.2014.

Coal used	7,000 Tonnes @ ₹ 28 per tonne
Coke Produced and Sold (main product)	4,900 Tonnes, Selling Price being ₹ 56 per tonne
Tar produced	280 Tonnes @ ₹ 60 per tonne
Sulphuric, etc.	70 Tonnes @ ₹ 210 per tonne
Benzole etc. produced	67 Tonnes @ ₹ 95 per tonne
Raw Material used	₹ 54,600
Wages paid	₹ 20,500
Repairs and Renewals	₹ 12,000
Salary and General Charges	₹ 7,500

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- (b) The following is a summary of the Profit and Loss Account of M/s. Straw Berry Company Limited for the year ended 31.03.2014

		₹ in lakh
Sales		13,540
Cost of Sales:		
Raw Materials, Stores and Spares	5,600	
Excise Duty	830	
Salaries and Wages	1,400	
Power and Fuel	470	
Repairs and Maintenance:		
Major Breakdown Repairs	35	
Other regular maintenance	94	
Carriage Outwards	320	
Insurance General	34	

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Insurance-Transit	22
Advertisement and Sales Promotion	720
Rent, Rates and Taxes	97
Printing, Stationery etc.	437
Travelling and Conveyance	776
Other Administrative expenses	426
Depreciation	391
Interest	1,494
Profit	13,146
	394

There was a major breakdown of machinery resulting in loss of production for 42 days, in June and July, 2013 and a labour strike for 97 days from 14.2.2014 to 21.5.2014. The Company produced a single product (Steel-Billet) and the production during the year was 942000 kgs.

You are required to compute the amount of abnormal cost on account of the breakdown and strike and the impact on cost per unit of output. Where do these figures find a place in the Cost Audit Report? 10

Answer:

1. (a)

**Monthly Cost Sheet of Coke Oven Company Limited
for the Financial Year ended 31st March 2014**

Particulars	Total Cost (₹)	Cost per Ton (₹)
Coal used (7,000 tonnes x ₹ 28)	1,96,000	
Raw Material used	54,600	
Wages	20,500	
Repairs and Renewals	12,000	
Salary and general charges	7,500	
	2,90,600	
Less: Value of By-product		
Tar produced (280 tonnes x ₹ 60)	16,800	
Sulphur etc. (70 tonnes x ₹ 210)	14,700	
Benzole etc. (67 tonnes x ₹ 95)	6,365	37,865
Cost of Coke Produced (4900 tonnes)	2,52,735	51.58
Profit (Balancing figure)	21,665	4.42
Sales Revenue (4900 Tonnes x ₹ 56)	2,74,400	56.00

(b) Period Costs incurred when there is no production are deemed as abnormal and the costs apportioned for such periods are excluded from cost of production of the product.

Particulars	₹ in lakh
Salaries & Wages	1,400
General Insurance	34
Rent, rates & taxes	97
Other administrative expenses	426
Depreciation	391
Interest	1,494
Total Fixed Cost	3,842

Total period of production stoppage:

Due to machinery breakdown	42 days
Due to strike 14.02.2014 to 31.03.2014	46 days
	88 days

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Fixed Costs apportioned to the period of production stoppage

= ₹ 3842 lakhs x 88 / 365	₹ 926.29 lakhs
Major breakdown repair	₹ 35.00 lakhs
Total abnormal cost	₹ 961.29 lakhs

This work out to approximately 9.85% of the total cost of production and should be excluded from the respective elements of cost in the cost sheets and should be stated in Reconciliation Statement of Para 7 to the Cost Audit Report.

The abnormal cost included in Cost of Production is ₹9,61,29,000/9,42,000 = ₹102.05 per Kg.

Working Notes:

Cost of Production (As per Para 5)

	₹ in lakhs
Raw Materials, Stores and Spares	5,600
Salaries & Wages	1,400
Power & Fuel	470
Repairs and Maintenance	129
Insurance General	34
Rent, Rates & Taxes	97
Printing, Stationery	437
Travelling & Conveyance	776
Other Admn. Exp.	426
Depreciation	391
Cost of Production	9,760

$$\text{Abnormal cost} = \frac{961.29 \times 100}{9760} = 9.85\%$$

Note:

- (i) Excise Duty is not forming part of Cost of material.
- (ii) Carriage Outward and Insurance-Transit are considered not forming part of Cost of Production.
- (iii) Advertisement and Sales Promotion and Interest are not forming part of Cost of Production.

2. (a) What procedure are to be followed for appointment of cost auditor?

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(b) Harish is an employee of M/s. Prix Co. and gets following emoluments and benefits

(i)	Salary	₹ 2,500 per month
(ii)	Dearness allowance	
	On first ₹ 1,000 of salary	₹ 4,000
	On next ₹ 1,000 of salary	₹ 1,000
	On balance of every ₹ 1,000	₹ 500 or @ 50% of part thereof
(iii)	Employers Contribution to Provident Fund	8% of Salary and D.A.
(iv)	Employer's Contribution to ESI	4% of Salary and D.A.
(v)	Bonus	20% of Salary and D.A.
(vi)	Other allowance	₹ 2,725 per annum

Harish works for 2400 hours per annum, out of which 400 hours are non-productive but treated as normal idle time. A worker works for 18 effective hours in job No. 11, where the cost of direct labour is @ effective hourly cost of Harish and direct material equal to

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direct labour cost, overhead applied is 100%, of Prime Cost.

The sale value of the job is quoted to earn a profit of 15%.

You are requested to find out:

- (A) Effectively Hourly cost of Harish, and
(B) The effective sale value of job No. 11.

4x2=8

Answer:

2. (a) Procedure for appointment of Cost Auditor -

Cost audit Branch of Ministry of Corporate affairs has set out the revised procedure for appointment of Cost auditor which was made applicable from 1st April 2011.

- (i) The company required to get its cost records audited under Companies Act shall appoint cost auditor, as defined cost accountant as per Cost and Works Accountant, 1959 who hold a valid certificate of practice including the Firm of cost accountant. The cost accountant or partners of the firm of cost accountant should be in whole time practice and not holding any other employment.
- (ii) Under the revised procedure, the Audit Committee to be ensured that cost auditor is free from any disqualification as specified under the Companies Act. The Audit Committee should also ensure that cost auditor is independent and is at arm's relationship with the company. After ascertainment of the eligibility, the Audit committee will recommend to the Board of Directors. In those companies where Audit Committee is not required as per the law function of Audit Committee will be discharged by the Board of Directors.
- (iii) The cost auditor will be required to give a separate certificate to the Audit Committee in respect to his/its independent and arm's length relationship with the company.
- (iv) The company is to e-file its application with the Central Government on www.mca.gov.in portal, in the prescribed Form 23C within 90 days from the date of commencement of each financial year, along with the prescribed fees as per the Companies (Fees and application) Rules, 1999
 - (a) Certified copy of Board resolution proposing appointment of Cost Auditor.
 - (b) Copy of the certificate obtained from Cost auditor regarding compliance of Companies Act.
- (v) After filing the online application by the company, the same shall be deemed to be approved by the Central Govt. if unless contrary is hard within 30 days from the date of filing such application.
If within 30days Central Govt. directs the company to resubmit form 23 C along with additional information or explanation as may be specified in the direction, further 30days to be counted for deemed approval is to be counted from the date of resubmission of the form 23C by the company.
- (vi) After obtaining approval or deemed approval from Central Govt. the company to issue formal letter to Cost Auditor.
- (vii) The Cost Auditor is to require informing Central Govt. within 30days of receipt of the letter of appointment Cost Auditor to file e-form 23D along with the copy of such appointment letter.
- (viii) The Company is required to disclose full particulars of Cost Auditor along with the due date and actual date of filing the cost audit report by the cost Auditor in its Annual Report for each relevant financial year.

(b) (A) Harish's Earnings:

1	Salary		₹2,500 per month
2	D.A.		
	On first ₹ 1000	₹4,000	
	On next ₹1000 of salary	₹1,000	
	On balance ₹500 of Salary	₹250	₹5,250 per month
3	Total Salary and D.A.		₹7,750 Per month

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4	Annual salary and D.A.		₹93,000 per annum
5	Employer's contribution to PF(8% Of 4)		7,440
6	Employer's contribution to ESI(4% Of 4)		3,720
7	Bonus (20% of 4)		18,600
8	Other allowance		2,725
9	Total annual earnings		1,25,485
10	Annual working hours		2,400
11	Less normal idle time		400
12	Effective annual working hours		2,000
13	Effective hourly cost of Harish =₹1,25,485/2,000 hr	₹ 1,25,485/2,000 hr =₹62.74 per hour	

(B) Statement showing effective sales value of job no. 11.

Direct labour cost (₹62.74X18 hrs)	1,129.32
Direct material cost	1,129.32
Prime Cost	2,258.64
Overhead (100% of prime cost)	2,258.64
Total cost	4,517.28
Profit (Balancing Figure)	797.17
Sale value (4517.28 x 100/85)	5,314.45

3. (a) What are "waste Multiplier" in Textile Costing? The following are the process wise wastages on inputs in the year

Process	%age of wastage on input
Blow Room	9.18
Carding	7.17
Drawing	1.1
Roving (Simplex)	0.3
Ring Frame (Shinning)	7.21
Reeling and Winding	1.5

From the above calculate the process wise waste multiplier factor.

2+5=7

- (b) In dealing with the financial position of a company as per para 9 of the Annexure in line with the new Companies (Cost audit Report) Rules, 2011, State your opinion regarding:

- (i) Should investments like National Savings Certificates deposited with Govt. Authorities like Sales tax authorities etc. as securities be treated as investment outside the Business?
- (ii) Is the Capital employed to be computed as at the beginning of the year or at the end of the year or average of both?
- (iii) In case the financial accounts of the company are yet to be finalised and audited, should the cost auditor provide the data under Para 9 in line with the new Companies (Cost audit Report) Rules, 2011?
- (iv) How is "Net Worth" defined in this para? The para also states that "If there is any change in the composition of the net worth during the year, special mention may be made along with the reasons there for." How you would take the care of this provision?

2x4=8

Answer:

3. (a) "Waste multiplier" is the quantity of output from any process, which will be needed to get one unit of final output. To arrive waste multiplier processing cost per kg of output is worked out. These costs are then aggregated to arrive at total yarn cost. This is done by using a factor known as Waste multiplier.

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Process	% of wastage on input	Net output for 100 units of input	Waste multiplier
Total			1.3161
Blow room	9.18	100-9.18 =	90.82
Carding	7.17	90.82-7.17/100X90.82 =	84.31
Drawing	1.10	84.31-1.10/100X84.31 =	83.38
Roving(Simplex)	0.30	83.38-.30/100X83.38=	83.13
Ring Frame(Spinning)	7.21	83.13-7.21/100X83.13=	77.14
Reeling and winding	1.50	77.14-1.50/100X77.14=	75.98

Calculation of Waste Multiplier-

Total	Wm0=Actual input/Actual output	100/75.98	1.3161
Blow room	wm1=WM0 X Net output/Actual Input	=1.3161X90.82/100	1.1953
Carding	wm2=Wm1 X Net output/Actual Input	=1.3161X84.31/100	1.1096
Drawing	wm3=WM2 X Net output/Actual Input	=1.3161X83.38/100	1.0974
Roving(Simplex)	wm4=WM3 X Net output/Actual Input	=1.3161X83.13/100	1.0941
Ring Frame(Spinning)	wm5=WM4 X Net output/Actual Input	=1.3161X77.14/100	1.0152
Reeling and winding	wm6=WM5 X Net output/Actual Input	=1.3161X75.98/100	1.0000

- (b) (i) Such investments in normal course of business and for the purpose of business. Therefore they cannot be treated as investment outside the business.
- (ii) Capital employed has been defined in the Rules as average of net fixed assets plus net current assets existing beginning and close of the financial year.
- (iii) Where the financial accounts of the company are yet to be finalized at the time of submission of the Cost audit Report, cost auditor may indicate in his report all financial data under para-9 on the basis of the unaudited or provisional accounts. This is necessary as all cost statements contain a lot of data which have a linkage with to the financial accounts. After the accounts have been finalized, a supplementary cost audit report should be submitted as soon as the audited accounts are made available.
- (iv) The term "Net Worth" is defined as Share capital plus Reserves and Surplus (excluding revaluation reserve) less accumulated losses and intangible assets. In other words Net worth = Share capital (paid up capital-equity and preference shares) + Reserve and Surplus - Revaluation Reserve - Intangible assets - Debit balance of Profit and Loss Account - Miscellaneous deferred expenditure. Under the rules there is no referee to the funds deployed in Capital work in progress and Fixed assets held for Sale. The intention of Law is to measure operational efficiency of the funds deployed by the company in operation. Therefore fund deployed in non-operational assets excluded from calculation of Net worth.

A reconciliation of net worth in following forms may be provided:-

Net worth at beginning of the year	**
Add: Increase in Capital	**
Add: Increase in Reserve	**
Less Decrease in Reserve	**
Less Any loss during the year	**
Less Any acquisition of intangible asset or any deferred expenses incurred	**
Net worth at the end of year	**

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4. (a) What process is to be followed to file the Cost Audit Reports in XBRL Format? 5
 (b) BURNET LTD., a manufacturing unit, provides the following extracts from its records for the year ended March 31, 2014:

The Company's specifications capacity for a machine per hour	1,500 units
No. of shifts (each shift of 8 hours) per day	3 shifts
Paid Holidays in a year (365 days):	
(i) Sunday	52 days
(ii) Other holidays	12 days
Annual maintenance is done within these holidays	---
Preventive weekly maintenance for the machine is carried on during Sundays	
Normal idle capacity due to lunchtime, shift changes etc. per shift	1 hour
Production based on sales expectancy in past 5 years (units in Lakh):	
75.70	75.70
87.42	87.42
65.38	65.38
77.97	77.97
76.08	76.08
Actual Production for the year (units in lakh)	81.50

You are required to calculate:

- (i) Installed Capacity
- (ii) Practical Capacity
- (iii) Actual Capacity
- (iv) Normal Capacity
- (v) Idle Capacity
- (vi) Abnormal Capacity

Keeping in view of the relevant Cost Accounting Standard (CAS-2). 1+2+1+2+2+2=10

Answer:

4. (a) The following steps are to be followed in sequence:

- Mapping the individual cost elements of the Company to the elements of costing taxonomy.
- Populating relevant data in the soft ware/ filing tool.
- Creating instance document.
- Validating the instance document with the validation tool of MCA.
- Use available tool to convert the instance document to a human readable format and check correctness of data.
- Attaching instance document to the e-form and filing on MCA portal.

(b)

Burnett Ltd

Calculation of different capacities

- (i) Installed Capacity: $365 \times 8 \times 3 \times 1500 = 131.40$ lakh units
- (ii) Practical capacity: $(365-52-12) \times (8-1) \times 3 \times 1500 = 94.815$ lakh units
- (iii) Actual capacity Utilization: $(81.50 / 131.40) \times 100 = 62.02\%$
- (iv) Normal capacity: $(87.42+77.97+76.08) / 3 = 80.49$ lakh units
- (v) Idle Capacity: $(131.40-81.50) = 49.90 / 131.40 = 0.3798 = 37.98\%$
- (vi) Abnormal Idle capacity: $(94.815 - 81.50) = 13.315$ lakh units

5. (a) The following particulars pertaining to Product-A are extracted from the record of PROTECT LTD. for the Half year ended March 31, 2014:

	(Amount in ₹ thousand)
Direct Material Cost per unit inclusive of Excise Duty ₹ 191 thousand	1,740
Direct Wages & Salaries	1,260

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Direct Expenses	200
Indirect Materials	253
Factory Overheads-	677
Administrative Overheads (25% relating to Production activities)	1,240
Quality control Cost	525
Research and Development Cost	360
Sale of scrap realized	180

You are to determine the cost of production for purpose of captive consumption in terms of Rule 8 of the Central Excise Valuation (DPE) Rules 2000 and as per CAS-4 and Assessable Value for purpose of paying excise duty on captive consumption. 6+2=8

- (b) The companies (Cost Accounting Records) Rules 2011 have not prescribed any specific formats for the cost statements. In what manner and Format would the cost statements be kept under these Rules? 3
- (c) How would you treat future remediation or disposal costs under CAS-14 relating to Pollution Control Costs? 2.
- (d) Whether film Industry like film producing companies/studios registered under Indian companies Act covered under companies (Cost Accounting Records) Rules 2011? 2

Answer:

5. (a)

Protect Ltd
Computation of Cost of Production (as per CAS - 4)

Particulars	(Amount in ₹ Thousand)
Direct Material excluding Excise duty (1740-191)	1,549
Direct wages and salaries	1,260
Direct Expenses	200
Works Overhead (253+677)	930
Quality Control C-cost	525
Research and development cost	360
Administrative Overhead (relating production activities)	310
Less: Sale of scrap	180
Cost of Production	4,954
Add: 10% as per rule -8 of CEV (DPE) Rules	495.40
Assessable value as per Rule 8 of the CE valuation Rules of 2000	5,449.40

- (b) As per sub rule (2) of Rule 4, the companies are required to maintain cost records on regular basis in such manner so as to make it possible to calculate per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly/quarterly/half-yearly/annual basis. The cost statements are to be prepared for every unit and every product produced, processed, manufactured or mined.

As per sub rule (3), the cost records are to be maintained in accordance with the generally accepted cost accounting principles and cost accounting standards issued by the Institute, to the extent these are found to be relevant and applicable.

These Rules have not prescribed any specific formats for the cost statement. A guidance note on the subject is under preparation by the Institute of Cost Accountants of India (ICAI), inter alia, containing model formats for cost records, statements, schedules etc.

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- (c)** Future remediation or disposal costs which are expected to be incurred with reasonable certainty as part of onerous contract or constructive obligation, legally enforceable shall be estimated and accounted based on quantum of pollution generated in each period and the associated cost of remediation or disposal in future.
- (d)** Companies (Cost Accounting Records) Rules, 2011 is applicable to developing, fixing, and washing exposed photographic or cinematographic film or paper to produce either a negative image or a positive image. In case a film producing company is also engaged in these activities, the same would be covered.

Section B (20 marks)
Answer any two questions.

10x2=20

- 6. (a) Write a short note on disclosure and transparency of corporate governance. 5**
(b) State the essential qualities required of a Management Auditor. 5

Answer:

6. (a) Disclosure and transparency of Corporate Governance include the followings:

1. Disclosure should include, but not be limited to, material information on:
 - (i) The financial and operating results of the company.
 - (ii) Company objectives
 - (iii) Members of the board and key executives and their remuneration.
 - (iv) Material foreseeable factors
 - (v) Material issue regarding employees and other stakeholders.
 - (vi) Governance structures and policies.
 - (vii) Major share ownership & voting rights.
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) The Essential Qualities Of A Management Auditor are:

- (i) Ability to grasp business problems.
- (ii) Ability to determine or assist the progress of the organization.
- (iii) Knowledge of the principles of delegation of authority and control and the preparation of different budgets.
- (iv) Power of grasping and understanding different internal control devices.
- (v) General understanding of different laws.
- (vi) Sufficient knowledge and experience in preparing various reports for submission to different levels of management including the top management.
- (vii) Tactfulness, perseverance, pleasing and dynamic personality.

- 7. (a) What do you understand by Corporate Services Audit? Describe the areas covered by Corporate Services Audit. 5**
(b) Classify Internal Control in four main categories. 5

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Answer:

7. (a) 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 behavior 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.

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

- (i) **Consumers:** Quality of goods in right quantity at right price, right place and right time.
- (ii) **Employees:** Pay, Safety, Welfare and Industrial Relations etc.
- (iii) **Shareholders:** Safety of investment, satisfactory return and capital appreciation.
- (iv) **Community:** Social cost and social benefit, public relation
- (v) **Fellow-businessmen:** Business ethics and fair trade dealings.
- (vi) **State:** Compliance with various legislations, fair trade practices, payment of taxes etc.

(b) Internal control can be classified into main four categories as follows:

- (i) **Administrative Control** - Administrative control include all types of managerial controls relating to the decision making process. An example of administrative controls is the maintenance of records giving details of customers contacted by salesman.
- (ii) **Operational Control** - This is exercised through management accounting techniques namely budgetary control, standard costing etc.
- (iii) **Financial And Accounting Control** - This control refers primarily the management plans, objectives and procedures that are concerned with the safeguarding of assets, prevention and detection of fraud and error, accuracy and completeness of accounting records and timely preparation of financial information.
- (iv) **Compliance Control** - These control aim at ensuring compliance with applicable laws and regulations. These controls also help to ensure compliance with laws regarding the system and intellectual property.

8. (a) What is Marketing Audit? What are its essential features?

5

(b) State briefly mandatory review area of the Audit Committee.

5

Answer:

8. (a) Marketing Audit is an independent examination of the entire marketing effort of a Company. Marketing activities covering objectives, programme implementation, and organization for purpose of determining what is being done, and appraising and recommending what needs to be done in future for sustain the growth of the company in future.

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The essential features of the Marketing Audit are that the Marketing Audit carried out periodically at regular intervals and not only when the company is facing marketing problems and difficulties. Such audits covers marketing place and control and evaluate the basic frame work for marketing action and also the performance. It covers also the entire system and process of marketing taking into account all the function of marketing operations.

Marketing Audit may be horizontal or vertical. Horizontal Audit covers a major part of the Marketing Audit and evaluates the total appraisal of the marketing efforts of a company. Vertical Audit concentrates on single item of function of marketing operation of a company.

The Marketing Audit covers the following areas.-:

- (i) **Objectives**:- Marketing objectives should be clearly established. Major of the companies do not have clearly defined objective except achieving high sales volume or making high profit on the sales. The search in audit of a clear objective will make the management aware of the gap between the operational policies.
- (ii) **Programme**:- The auditor should carry out an appraisal for the programme which the company laid down for achieving the objective.
- (iii) **Implementation**:- The auditor should take up the examination of the company's implementation of the marketing programme.
- (iv) **Organization**:- A suitable organization assist in a success of a marketing plan. The audit should appraisal the marketing organization by reviewing the formal lines of authority and responsibility, delegation of authority, status of marketing head and his staff, adequacy of the personnel, proper manning of key tasks and assignment etc.

(b) Mandatory Review Areas of the Audit Committee

The Audit Committee shall mandatorily review the following information as per Clause 49 of the Listing Agreement:

- (i) Management discussion and analysis of financial condition and results of operations
- (ii) Statement of significant related party transactions (as defined by the audit committee), submitted by management
- (iii) Management letters/ letters of internal control weaknesses issued by the statutory auditors
- (iv) Internal audit reports relating to internal control weaknesses; and
- (v) The appointment, removal and terms of remuneration of the Chief Internal Auditor shall be subject to review by the Audit Committee.

Section C (20 marks)

Answer any two questions.

10x2=20

9. What are the characteristics of a good performance Appraisal Report?

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Answer:

9. Characteristics of a good Performance Appraisal Report are as follows -

- (i) It should be remembered that the Performance Appraisal Report is meant to be used by the company and this report is confidential.
- (ii) The report, being an annexure to the cost audit report, should basically lay more thrust on the cost management aspect of the business and should effectively bring out comments on how the business performance could be improved by elevating the cost performance.
- (iii) When commenting on or analyzing the cost performance, the cost auditor could

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assess the impact of changes in the costs on the profitability of the products, profitability by customers or market segments.

- (iv) The cost drivers that are the fulcrum of the cause and effect relationship in the cost statement are the ones which form the first level of KPIs that are easily understood and actionable for the operational executives. The cost auditor while evaluating the KPIs can also look at the efficacy of the cost drivers. This evaluation will also enable the operational executives to relate what is being done at the shop floor to the cost statements that are the end product of the cost accounting system.
- (v) It would be necessary to analyze the use of various resources to boost economy, efficiency and effectiveness of the operations. Economy indicates incurring of the least possible cost for acquiring and/or utilizing the resources, without compromising the quality. Efficiency denotes maximization of the output-input ratio. Effectiveness means achieving the desired goals. The Performance Appraisal Report should cover, at the minimum, all the three aspects of cost management.
- (vi) For being a valuable report Performance Appraisal Report should portray analysis of a range of performance measures. While selecting these measures, care should be taken to include those having a material impact on the past or future performance of an organization. These measures could change over period of time and may require to be reconsidered for inclusion to or exclusion from the Performance Appraisal Report.
- (vii) The following criteria may help the cost auditor to select and include the various performance measurement criteria in the Performance Appraisal Report:
- Effect on profitability
 - Effect on resource utilization
 - Effect on liquidity
 - Effect on risks
 - Effect on quality
 - Effect on competitiveness
 - Effect on responsiveness to the market etc.
- (viii) The Performance Appraisal Report should include non-financial performance indicators in addition to the use of traditional financial ratio analysis. The non-financial measures provide useful information about the probable future of performance of the company. E.g. a consistently good customer satisfaction index would guarantee a certain growth in business.
- (ix) An ideal Performance Appraisal Report should possess the following characteristics:
- Objectivity
 - Capability of being predictive value
 - Comprehensiveness
 - No information overload
 - Coverage of strategic thrust
 - Trend measures and current status
 - Timeliness
 - Segmented and enterprise-wide coverage

10. The following information pertains to REACON CEMENT LTD., a manufacturing cement company for the year that ended as follows:

The year ended March 31.	2013-14	2012-2013
Rated Capacity per Hr (in MT)	80	80
Break down (Hrs)	2,177	1,015

Suggested Answer_Syl12_Jun2014_Paper_19

Planned Maintenance (Hrs)	247	422
Power restrictions (Hrs)	1,237	1,481
Shortfall (there are no orders) (Hrs)	792	677
Want of wagons (Hrs)	495	635
Total stoppage (Hrs)	4,948	4,230
Total running (Hrs)	3,888	4,582
Total available Hours	8,836	8,812
Production during the year (in MT)	2,48,844	3,29,928
Hourly Rate of Production (in MT)	64	72
Capacity Utilization (%)	62.21	82.48
Annual Installed Capacity (in MT)	4,00,000	4,00,000

Based on information stated above, you as a Cost Auditor are required to offer your comments on

- (i) The performance of the company
- (ii) Your suggestion for improvement.

10

Answer:

10.

Reacon Cement Ltd.

(i) Performance of the Company

(a) Rated capacity = 80 MT/Hr : Rated capacity achieved in 2012-13=(72/80)x100 =90%
Rated capacity achieved in 2013-14= (64 /80)x100 = 80%

The capacity achievement as % of rated capacity has declined from 90% to 80% in 2013-14.

Further the Capacity Utilization has gone down to 62.21% in 2013-13 from 82.48% of previous year; a reduction of 20.27%

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

1. Breakdown hours have gone up from 1,015 hours to 2,177 hrs, an increase by 114.48%
 2. Planned Maintenance hrs has reduced from 422 hrs to 247 hrs i.e. by 41.47%
 3. Shortfall hrs due to lack of orders has increased from 677 hrs to 792 hrs i.e. by 16.99%
 4. The total stoppage hrs. has increased from 4,230 hrs to 4,948 hrs i.e. by 16.97%
 5. The total running hrs has come down from 4,582 hrs to 3,888 hrs i.e. by 15.15%
 6. The production has come down from 3,29,928 Mt to 2,48,844 Mt i.e. by 24.58%
- From the above findings, it can be pointed out that the under utilization of capacity to the extent of little over 20% can be attributed mainly to:-
- Increased total stoppage hours of 4,948 of 2013-14 as against that of 4,230 hrs in 2012-13 and
 - The net increase of 718 hrs (4,948-4,230) is again due to increase of breakdown by 1,162 hrs (2,177-1,015) in the year 2013-14

(ii) Suggestion:

Therefore, the Company should look into the aspect of proper maintenance, securing sufficient orders to avoid lost 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.

11. ALLIED LTD. has the following Balance Sheet as on March 31, 2014 and March 31, 2013.

(Amount in ₹ Lakh)

Year ended March 31	2014	2013
SOURCES OF FUNDS:		
Shareholders' Fund	2,972	1,886

Suggested Answer_Syl12_Jun2014_Paper_19

Loan Funds	4,644	4,060
	7,616	5,946
APPLICATIONS OF FUNDS:		
Fixed Assets	4,279	3,600
Cash and Bank	707	684
Debtors	1,914	1,522
Stock	3,560	3,008
Other Current Assets	2,000	1,805
Less: Current Liabilities	(4,844)	(4,673)
	7,616	5,946

The Income statement of ALLIED LTD. for the year that ended is as follows:

(Amount in ₹ Lakh)

Year ended March 31	2014	2013
Sales	26,718	16,778
Less: Cost of Goods Sold	25,152	15,173
Gross Profit	1,566	1,605
Less: Selling, General & Administrative expenses	1,242	782
Earnings before Interest & Tax (EBIT)	324	823
Less: Interest Expenses	256	246
Profit before Tax (PBT)	68	577
Less: Tax	28	230
Profit After Tax	41	347

Required:

- (i) Calculate for the year 2013-14:

 - (a) Inventory Turnover Ratio
 - (b) Return on Net Worth
 - (c) ROI
 - (d) ROE
 - (e) Profitability Ratios
 - (f) Give brief comments on the financial position of company

(1+1+1+2+3+2)=10

Answer:

11.

ALLIED Ltd

Various Ratios for the year 2013 – 2014

(a) Inventory Turnover ratio: $\frac{\text{Cost of Goods sold}}{\text{Average Inventory}} = 25,152/3,284 = 7.66$

$$(b) \text{ Return on Net Worth: } \frac{\text{Profit after Tax}}{\text{Net Worth}} = (40/2,972) \times 100 = 1.35\%$$

$$(c) \text{ ROI: } \frac{\text{Net Profit before Interest but after Tax}}{\text{Average capital employed}} = (296/6,781) \times 100 = 4.37\%$$

*NP before Interest and tax = 256 + 40 = 296

** Average capital employed = $7,616 + 5,946/2 = 6,781$

$$(d) \text{ ROE: } \frac{\text{PAT available to Equity share holders}}{\text{Average Shareholder's funds}} = \frac{40}{2,429} = 1.65\% \\ (2,972 + 1,886 / 2) = 2,429$$

- (e) Profitability Ratios:

Gross Profit Ratio = $(1,566/26,718) \times 100 = 5.86\%$

Operating Profit Ratio = $(68+256) / (324 / 2,6718) \times 100 = 1.21\%$

Net Profit Ratio = $(40 / 2,6718) \times 100 = 0.15\%$.

Suggested Answer_Syl12_Jun2014_Paper_19

- (f) **Comment:** There is a substantial decline in Profitability in the current Year from ₹ 823 Lakhs of previous year to ₹ 324 Lakhs. This is mainly due to huge increase in the operating expenses. There has been substantial increase in the Interest charges also. During the year 2013-14 both fixed financial expenses and operating expenses have increased. During current year both operating and financial leverages have been adversely affected. It can be seen that the company is suffering from a liquidity crisis during the year.