

**FINAL EXAMINATION  
GROUP - IV  
(SYLLABUS 2012)**

**SUGGESTED ANSWERS TO QUESTIONS**

**JUNE - 2017**

**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.

SECTION – A has one question which is compulsory. Attempt this question.

SECTION – B has seven questions. Attempt any five of them.

Working Notes should form part of the respective answers.

Wherever necessary, suitable assumptions may be made and disclosed by way of a note.

Please: (1) Answer all its of a question at one place.

(2) Open a new page for answer to a new question.

**Section – A (20 Marks)**

Answer the following:

1. (a) Fill in the blanks in the following sentences by using appropriate word(s)/phrase(s)/number(s). 1×5=5
  - (i) Rule 4 of the Companies (Cost Records and Audit) Rules, 2014 deals with the \_\_\_\_\_.
  - (ii) Abnormal Loss due to flood or earthquake is charged to \_\_\_\_\_.
  - (iii) Financial Position and Ratio Analysis has to be computed based on \_\_\_\_\_ data.
  - (iv) Responsibility Centre is \_\_\_\_\_ group of control centres.
  - (v) XBRL is a language based on \_\_\_\_\_ family of languages.
- (b) State whether the following statements given below are TRUE or FALSE. 1×5=5
  - (i) CAS 11 deals with Packing Material Cost.
  - (ii) Interest and Finance charges are part of cost of production.
  - (iii) All expenses that can be identified or linked with the cost object are termed as Direct Expenses.
  - (iv) Part B of the Annexure to Cost Audit Report deals with the Manufacturing Sector.
  - (v) A favourable budget variance is always an indication of efficient performance.
- (c) Answer any five of the following in one or two sentences. 2×5=10
  - (i) What are 'Industry-specific Operating Expenses'?
  - (ii) How to treat overtime premium as per CAS 7 related to Employee Cost?
  - (iii) State the broad objectives of 'Operational Audit'.
  - (iv) State the factors on which audit documentation will depend.
  - (v) What is the Central Excise Tariff Act Heading as per the Companies (Cost Records and Audit) Rules, 2014?
  - (vi) State the meaning of the term 'Key Performance Indicators'.

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Answer:

1. (a) (i) applicability of Cost Audit  
(ii) Costing Profit / Loss Account  
(iii) Audited Financial  
(iv) a personalized  
(v) XML
- (b) (i) False.  
(ii) False.  
(iii) False  
(iv) True.  
(v) False.
- (c) (i) Industry-specific Operating Expenses are those which are peculiar to a specific industry. For example, Telecommunications industry shows expenses such as Network Operating cost, License fee, Radio Spectrum charges, Microwave charges, etc., which are peculiar to this industry. The industry-specific operating expenses shall have to be identified and reported in the abridged cost statement.  
(ii) Overtime premium shall be assigned directly to the cost object or treated as overheads depending on the economic feasibility and specific circumstances requiring such overtime.  
(iii) Operational Audit is an organized search for the ways to improve efficiency and effectiveness. It has the broad objectives of a) Appraisal of Controls, b) Evaluation of Performance, c) Appraisal of Management Objectives, and d) Appraisal of Organization Structure. All large organizations conduct Operational Audit for better management and higher profitability.  
(iv) The content and form of audit documentation will depend on a number of factors, such as (a) the size and the complexity of the operations of the audited, (b) the extent of computerization of the cost records, (c) the assessed risks of material misstatement of costs, (d) the cost audit methodology and tools used, and (e) the nature of the audit procedure to be performed.  
(v) Central Excise Tariff Act Heading as per Companies (Cost Records and Audit) Rules, 2014, means the Heading as referred to in the Additional Notes as per the First Schedule of the Central Excise and Tariff Act. 'Heading', in respect of 'goods' means a description in respect of tariff provisions accompanied by a four-digit number and includes all sub-headings of all tariff item the first four digits of which correspond to that number.  
(vi) Key Performance Indicators are simply the variables, independent or inter-dependent, in respect of which goals can be set and performance can be measured to assess whether it is in furtherance of the enterprise objectives. These may be quantitative, qualitative, actionable, or trends. For evaluation of performance, the choice of the indicators should be made correctly in tune with the objectives.

### Section - B (80 marks)

Answer any five questions (carrying 16 marks each) from question No. 2 to question No. 8.

2. (a) The following data relate to the cotton cost of PQR Cotton Mills for January - March, 2017:

(bales are of 180 kg. average)		(Amount in ₹ '000)
Opening Stock of Cotton	5000 Bales	44,366
Purchase of Cotton	17500 Bales	1,56,000

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Closing Stock of Cotton	3500 Bales	
Freight Inwards		595
Demurrage charges to transporter		11
Normal Loss due to moisture loss		1% of material

Find the value of the materials consumed and Closing Stock. 8

(b) Discuss the concept of 'Evidence' in relation to Management Audit. 8

Answer:

2. (a) Computation of the Value of the materials consumed and the Closing Stock

Particulars	Quantity (Kgs.)	Amount (₹'000)
Opening Stock of Cotton	9,00,000 (5000 × 180)	44,366
Add: Purchase of Cotton	31,50,000 (17,500 × 180)	1,56,000
Add : Freight Inwards		595
Less: Normal Loss due to moisture loss (1% of materials)	40,500	
<b>Total</b>	40,09,500	2,00,961
Average of Total	Cost of Cotton/Kg. (average)	50.1212 9 (approx.)
Less : Value of Closing Stock 6,30,000		31576.36
Cost of Cotton (Materials) Consumed(4009500 - 630000)kg		1,69,384

(b) Unlike financial audit or other audits, there can be no fixed items of evidence to be checked by a Management Auditor. A Management Auditor has to rely more on his/her experience and acumen to identify the areas of review and study, particularly the weaknesses to be overcome, the strengths to be exploited and the risks to be properly covered. The auditor's evidence comes from the points mentioned below:

- (1) His/her discussions with the people concerned in the organization
- (2) The survey and review of various reports of the organization, including important departmental internal audit reports, inspection reports or any investigation reports, physical inspection, test examination of various transactions, inspection of files, monthly performance review statements, minutes and notes and above all personal observations.
- (3) Evidence can be gathered either by sampling techniques or by going into full details, depending upon what the samples reveal.
- (4) The evidence should be such that an auditor can draw valid conclusions, duly verifying the same with the people concerned.
- (5) There is no area of restrictions for obtaining evidence.

3. (a) The management of VDW Ltd. is worried about increasing labour turnover in the factory and, before analysing the causes and taking the remedial steps, the management wants to have an idea of the profit foregone as a result of the labour turnover in the last year.

Last year sales amount to ₹ 98,23,600 and the P/V Ratio was 20%. The total number of actual hours worked by the direct labour force was 5.23 lac. As a result of the delays by the Personnel Department in filling vacancies due to labour turnover, 100000 productive hours were lost. The actual labour hours included 30000 hours attributable to training new recruits, out of which half of the hours was unproductive. An analysis of

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cost incurred consequent on labour turnover revealed the following:

Settlement Costs due to leaving – ₹ 45,680

Recruitment Costs – ₹ 30,620

Selection Costs – ₹ 15,750

Training Costs – ₹ 37,250

Assuming that the potential loss as a consequence of labour turnover could have been sold at the prevailing prices, find out the profit foregone in the last year on account of labour turnover. 8

(b) The following data have been collected by you as a Cost Auditor of a company:

Particulars	2014 – 15	2015-16	2016-17
Installed Capacity (lac MT)	2.5	2.5	2.5
Production (lac MT)	2.4	2.3	1.25
Cost per MT of the product (₹)	1,000	1,077	1,660

The poor capacity utilization in 2016-17 was due to abnormal power cut. Escalation in costs were 5% in 2015-16 over 2014-15 and 2% more in 2016-17 over 2014-15.

(i) Calculate the Abnormal Cost due to power cut.

(ii) How would you treat this Abnormal Cost? 8

Answer:

3. (a) Productive hours worked = Actual hours worked – Unproductive hours  
 = 5,23,000 hrs – 15,000 hrs.  
 = 5,08,000 hrs.

Sales per productive hours = 98,23,600/5,08,000 = ₹ 19.34 (approx.)

Sales foregone due to potential productive hours lost = 1,00,000 × 19.34 = ₹ 19,34,000

Contribution foregone on sales lost = Sales foregone × P/V Ratio  
 = 19,34,000 × 20/100  
 = ₹ 3,86,800

### Statement of Profit Foregone due to Labour Turnover

	₹
Contribution foregone	3,86,800
Settlement Costs due to Leaving	45,680
Recruitment costs	30,620
Selection Costs	15,750
Training Costs	37,250
<b>Profit Foregone due to Labour Turnover</b>	<b>516,100</b>

(b)

	Particulars	2014-15	2015-16	2016-17
a.	Installed capacity (lac MT)	2.5	2.5	2.5
b.	Production (lac MT)	2.4	2.3	1.25
c.	% of capacity utilization	96	92	50
d.	Cost per MT of the product (₹)	1000	1077	1660
e.	Escalation factor	100	105	107
f.	Cost at base year price (d × 100/e)	1000	1026	1551
g.	Cost of Production (₹ in lac) (f × b)	2400	2360	1939
h.	Variable Cost	400	400	400
i.	Fixed Cost	600	677	1260

Increase in Fixed Cost (in 2016-17 as compared to 2014-15) due to decrease in capacity utilization = 1260 – 600 = ₹ 660

(i) Abnormal Cost due to power cut = 660 × 1.25 = ₹ 825

(ii) The Abnormal Cost must be excluded from the computation of cost.

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### Notes:

	As compared to 2014-15	2015 – 16	2016 – 17
A.	Difference in Total Cost (₹ in lac)	40	461
B.	Difference in Productions (lac MT)	0.1	1.15
	Variable Cost per MT in ₹ (A/B)	400	400.869 = 400 (assume)

4. (a) (i) A paper manufacturing company having turnover of ₹ 90 crore, in the year 2016-17 was incorporated in 2015-16 and commenced its production from March, 2016. From which financial year, the Cost Audit will be applicable?  
(ii) Whether maintenance of Cost Accounting Records and Cost Audit thereof, subject to threshold limits prescribed, is applicable to products which are for 100% captive consumption? 4+4=8
- (b) Mr. R. Kulkarni was appointed as Cost Auditor of MNC Ltd. for the Financial Year 2016-17. State  
(i) How long the Cost Auditor can continue to hold office for the financial year?  
(ii) In what format the Cost Auditor shall submit his/her Report?  
(iii) What was the formality to be observed by the Board of Directors if the cost Auditor did resign on 31.01.2017? 3+2+3=8

### Answer:

4(a)

- (i) Rule 3 of the Companies (Cost Records and Audit) Rules, 2014, states that every company, engaged in the production of goods or providing services specified in the Rules, shall maintain Cost Records if the overall turnover from all its product and services is ₹ 35 crore or more during the immediately preceding financial year.

Applicability for Cost audit [Rule 4]

- (1) Every company specified in item (A) of Rule 3 [Regulated Sector] 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 [Non-regulated Sector] 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.

In the present case, the Paper Industry falls under the Non-Regulated Sector and is required to maintain cost records from the Financial Year 2017-18 but is not required to get its cost records audited from the same year since it did not cross the threshold limit in the preceding financial year 2016-17.

- (ii) The Companies (Cost Records and Audit) Rules, 2014, has specified different products and services for which maintenance of cost accounting records and Cost Audit thereof, subject to threshold limits prescribed, are mandatory.

In case a product is manufactured and 100% actively consumed for production of some other product which is also covered under the Rules and is subject to Cost Audit, then the cost of such captively consumed product would form part of the final product which is also under cost Audit and as such a separate Cost Audit Report for the captively consumed product will not be necessary;

If the product, however is partly for captive consumption and is partly sold, or if the product is 100% captively consumed for production of some other product which is not covered under the Rules, then Cost Audit would be applicable for such captively consumed product.

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- (b) (i) Rule 6(3) of the Companies (Cost Records and Audit) Rules, 2014, states that every Cost Auditor appointed by the Company shall continue in such capacity till the expiry of one hundred eighty days from the closure of the financial year or till he/she submits the Cost Audit Report for the financial year for which he /she has been appointed.
- (ii) According to Rule 6(4) of the Companies (Cost Records and Audit ) Rules, 2014 every cost auditor, who conducts an audit of the cost records of a company, shall submit the cost audit report along with his/her/its reservations or qualifications or observations or suggestions, if any, in form **CRA-3**.
- (iii) As per Rule 6(3) of the Companies (Cost Records and Audit) Rules, 2014, any casual vacancy in the office of the Cost Auditor, by resignation or otherwise, shall be filled by the Board of Directors within 30 days of occurrence of such vacancy. The procedure followed for such appointment shall be the same as that of fresh appointment. The company shall inform the Central Government in Form CRA 2 within 30 days of such appointment of Cost Auditor.
5. (a) **Grand Manufacture Ltd. received an enquiry for 250000 numbers of special type of machine parts. Capacity of the company exists for manufacturing the said parts but a fixed investment of ₹95,000/- and working capital (to the extent of 35% of sales value) will be required to undertake the job.**  
**The cost estimates are as follows:**  
**Raw Materials 40000 kg at ₹3. 00 per kg.**  
**Labour hours 12000 of which 800 would be overtime payable at double the normal rate**  
**Normal Labour rate- ₹ 3. 00 per hour**  
**Factory Overheads - ₹ 2.50 per direct labour hour**  
**Selling and Distribution Overheads - ₹ 45,400/-**  
**Materials expected to be recovered at the end of the operation- ₹12,000/-(estimated)**  
**The company expects a net return of 15% on Capital Employed.**  
**As a Management Accountant of the company, you are required to prepare a Cost and Price Statement, indicating the price to be quoted by the company to the customer and the Working Capital required to undertake the job. 8**
- (b) **Briefly state the disclosure and transparency requirements for Corporate Governance. 5**
- (c) **Is a Cost Auditor required to give any certificate with respect to his/her independence and 'arm's length relationship' with the appointing company? 3**

**Answer:**

4. (a) Statement of Estimated Cost and Price

Period from-----		
Product: Special Type Machine Parts		
Cost Units: 2,50,000		
Cost Items	Amount (₹)	Amount(₹)
Direct Material(40000*3)	120000	
Less : Material expected to be recovered at the end of the operation	12000	108000
Direct Labour (normal)[12000-800]*3	33600	
Overtime : 800*6	4800	38400
<b>PRIME COST</b>		<b>146400</b>
Add: Factory Overheads: 12000*2.50		30000
<b>FACTORY COST</b>		<b>176400</b>
Add: Selling and Distribution Overheads		45400
<b>Cost of Goods Sold</b>		<b>221800</b>
profit(balancing figure)		26674

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Sales( As per working notes)		248474
Selling price per unit ₹ ( the price to be quoted)		0.9939

### Working Notes:

Calculation of Total Sales

Let Sales be S

$S = \text{Total cost} + 15\% \text{ of Capital Employed}$

$S = 2,21,800 + 15/100 \times (95,000 + 0.35 \text{ of } S)$

$S = 2,21,800 + 0.15 (95,000 + 0.35S)$

$S = 2,21,800 + 95,000 \times 0.15 + 0.35 \times 0.15 S$

$S = 2,21,800 + 14,250 + 0.05 S$

$S - 0.05S = 2,36,050$

$0.95S = 2,36,050$

$S = 2,36,050 / 0.95 = 2,48,474 / \text{Sales} = ₹2,48,474$

**Working Capital required** = 35% Sales =  $35/100 \times 2,48,474 = ₹ 86,966$

5. (b)

1) Disclosure and transparency requirement for Corporate Governance are stated below :

Disclosure should include but not limited to material information on –

- Financial and Operating results of the company
- Company Objectives
- Membership of the board and their remuneration and the key objectives
- Material issues regarding employees and other stakeholders
- Governance structure.

2) Information should be prepared, audited and disclosed in accordance with the quality standards of accounting, financial and non-financial disclosures and audit.

3) An annual audit should be conducted by an independent auditor in order to provide an external 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 the users.

5) The Company should maintain minutes of the meeting explicitly, recording dissenting opinions, if any.

(c) Yes, The Cost Auditor of a company is required to give a certificate to the Audit Committee in respect of his / her / its independence and arm's length relationship with the company.

Also, according to the Second Schedule , Part 1 clause 4 of the The Cost and Works Accountants Act , 1959 it amounts to professional misconduct when a Cost Auditor expresses his opinion on cost or pricing statements of any business or enterprise in which he, his firm or a partner in his firm has a substantial interest;

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- 6 (a) What is Energy Audit and what are the functions of an Energy Auditor? 2+4=6
- (b) What is 'Marketing Audit'? Enumerate its different application areas. 2+3=5
- (c) A company desires to implement a Management Audit programme in the company. You are a Cost and Management Auditor. The company assigns you the job for smooth implementation of the Management Audit programme. What are the criteria to be considered before implementation of the management Audit programme in the company? 5

### Answer:

6. (a) 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". Energy Audit is an activity that serves the purposes of assessing energy use pattern of a factory or energy-consuming equipment and identifying energy-saving opportunities. In this context, energy management involves the basic approaches reducing avoidable losses, improving the effectiveness of energy use, and increasing energy use efficiency. The energy auditor is normally expected to give recommendations on effective improvements leading to monetary benefits and also to 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 correlate trends of production or activity to energy cost. (iii) To devise energy database formats separately by products, departments or consumers. While performing the aforesaid key functions, the energy auditor is required to carry out the following activities: (1) To analyse the historical energy consumption and cost data. (2) To conduct preliminary energy audit with the objectives to identify: (a) Major energy consuming equipment and processes; (b) Obvious inefficiencies and energy wastes; and (c) Priority areas for further detailed investigation. (3) To conduct detailed technical and economic analysis of energy efficiency measures, involving large efficiency measures, involving large capital investment or long payback periods.
- 6(b) Marketing Audit is an independent examination of the entire marketing function or covers some specific marketing activities, covering objectives, plans, programme implementation and organization for the purposes of determining what are being done or what needs to be done for the future of the company. The Marketing Audit covers the following areas:
1. Objectives – The marketing objectives should be clearly defined to achieve high sales volume or making high profit on sales target. The search audit of a clear objective will require the Management Auditor to determine the operational policy and a defined goal.
  2. Programme – The Auditor should carry out an appraisal for the programme which the company has laid down in order to achieve the objectives.
  3. Implementation – He/she will take up the examination of the company's implementation of the marketing programme.
  4. Organisation – A suitable organization assists in success of a marketing plan. The audit should appraise the marketing organization by reviewing formal lines of authority and responsibility, delegation of authority, status of marketing head and staff, adequacy of personnel, proper manning, etc.
- 6(c) The criteria that are to be considered before implementing an efficient Management Audit programme shall comprise of the following:
1. Review of the organizational objectives and plans
  2. Study of the policies and practices of the management



3. A critical review of the organizational structure
  4. Study of the systems and procedures
  5. Evaluation of operations
  6. Study of the efficiency of the use of physical resources available
  7. Exercise of proper management control
  8. Maintaining suitable monitoring system through management information system
  9. Check on the adherence to the statutory obligation
  10. Above all, review the efficiency of manpower handling, which ultimately results in the organization's success
7. (a) What is it essential to implement proper Internal Control system in any organisation? 6
- (b) What action amounts to professional misconduct in relation to the members of the ICAI in service? 4
- (c) What are key functions of Inventory Auditors? 6

**Answer:**

7. (a) While designing an internal control system, the following factors must be considered to ensure greater chances of successful implementation of internal control system.
- **Segregation and Rotation of duties:** It is very necessary for successful internal control system that no one person handles the complete transaction i.e., those who physically handle assets are not those who record the asset movements also. The systems are so designed that no single individual is responsible for all the stages involved in a transaction i.e., duties are allocated in such a way that no single individual has an exclusive control over any one transaction or a group of transactions. Similarly, the people responsible for authorizing these transactions or reconciling of the records should also be different i.e., the work done by one person is either complementary to the work done by other person or the accuracy or correctness of work done by one person is independently checked by another person. The broad functions which are generally segregated are: (a) Execution of transactions; (b) Authorization of transactions; (c) Maintenance of records and documents; and (d) Physical custody of related assets. Apart from segregation of duties, it is sometimes considered more desirable to rotate the duties of various officers and staff in an attempt to ensure that a fraud or error, if any may not remain undetected for a very long time. It also ensures that a person does not develop a vested interest by holding to a post for a very long time. In addition, it removes the impression of indispensability about an employee. This also ensures that the job profile of each post is well defined because employees can be rotated only if the content of each respective job is well defined.
  - **Competence and integrity of people:** Internal control systems are not an end to themselves unless these systems are manned by the competent people, who are honest enough to consistently do so. The controls to be successful and effective necessitate the need for competent people to enforce such controls. In other words, the presence of detailed procedures may have no meaning unless these procedures are carried by the competent people, who can also envisage the changes required in the system over a period of time.
  - **Appropriate levels of authority.** A common error usually made is to grant too much authority within control boundaries. Sometimes, this is deliberately done to expedite the things or to handle the emergencies. This is sometimes done to reduce the number of people i.e., cost reduction. However, controls to be effective require the authority to be granted on a need-to have basis only. If there is no need for a

particular person to have a specific authority, he/she should not be granted such authority.

- **Accountability.** The internal controls to be successful, presuppose that there is full accountability for all the decisions taken and there are controls present, which allow the determination with acceptable level of confidence of a person taking particular decision or authorizing particular transaction or took specific action. However, mere presence of these controls may have no meaning or may give a false sense of security unless strict action is taken every time, a discrepancy is noticed. Other wise these controls may be left with no meaning.
- **Adequate resources.** Controls that are enforced with inadequate resources (manpower, finance, equipment, materials, and methodologies) will generally fail whenever they come under stress. Therefore, it is very necessary that minimum resources necessary to enforce the controls must always be present to enable the controls to be successful and effective.
- **Supervision and periodical updation:** Unfortunately, many people prefer to work only if they are being supervised or watched. It is, therefore very necessary for the controls to be adequately supervised and periodically updated in line with changing environment to be effective and successful. For example, in case of banks, if new service i.e., internet banking is also being started, it is very necessary that internal control system is also updated accordingly.

- (b) A member of The ICAI in service, i.e., other than a member in practice, shall be deemed to be guilty of professional misconduct, if he/she being an employee of any company, firm or person—
- (1) pays or allows to pay, directly or indirectly, to any person any share in the emoluments of the employment undertaken by him/her;
  - (2) accepts or agrees to accept any part of fees, profit or gains from a lawyer, a cost accountant or a broker engaged by such company, a firm or a person or an agent or a customer of such company, a firm or a person by way of commission or gratification.

7 (c) Inventory Audit involves the following aspects:

- (i) Physical Verification of Stock-- All stock normally must be physically verified. However, depending on the nature of the items and material flow, proper sampling technique may be used. A proper sampling procedure may be used for the entire stock. An ABC categorization may be done so that emphasis is given to entire stock.
- (ii) Method of Valuation Adopted – The main thrust of Inventory Audit is to check the accuracy:
  - (a) as per bank debit under LC or
  - (b) rate prevalent as per Bill of Entry (or Forward Rate, if Forward Contract has been taken).
- (iii) Movement or Currency of Stock – Movement of stock is to ensure by analyzing all items by fast, slow and non-moving character. In respect of slow and non-moving items, the fall in value due to obsolescence, deterioration, etc., have to be examined and reported.

In respect of spares parts, care must be taken to segregate items of spares relating to scrapped or replaced plant/machinery as these may not have any value.

In case of finished goods, return from customers for defects in quality must be given special importance on valuation.
- (iv) The basis of unit rate adopted must be consistent and must include
  - a) freight, insurance, octroi, packing, loading, unloading and incidental charges;
  - b) manufacturing cost upto stage of completion in case of finished goods.

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The report may be designed by the bank or the auditor. In any case, where the items need to be highlighted should be shown separately in Inventory Audit.

8. (a) What is ERP environment? How is the audit under ERP different from other audits? 6  
(b) When is 'Safeguard Duty' imposed? 5  
(c) What is 'Due Diligence' Audit? Why is it undertaken? 5

Answer:

- (8) (a) Enterprise Resource Planning (ERP) is the activities supported by multi-module application software, which helps the business in the management. It is a business management system that integrates all area of the business, including planning, purchasing, manufacturing, sales and marketing, etc., which may be located at different locations. It serves the information needs of an organisation's each department to know what is happening in each of the departments. They seek to combine the separate records relating to the same subject at one place making them completely reliable and comprehensive.

ERP is the software solution to address the enterprise needs taking the process view of an organization by tightly integrating all functions like inventory control, order taking, customer service, etc., into a unified system. It facilitates the enterprise-wide integrated information system, covering all functional areas. A key ingredient of most ERP systems is the use of a unified database to store data for the various system modules. The common database allows every department to store and retrieve information in real time. It allows information to be more reliable, accessible and easily shared.

The major characteristics of ERP systems necessitating change in the audit approach are stated below.

1. On-line real time processing
2. All transactions are stored in one common database
3. System usually resides on multiple computers
4. Optimum co-ordination is a challenge
5. Traditional "batch" controls and audit trails not available
6. Data bases can be accessed by any module
7. System modules are transparent to the user
8. Significant increase in number of users
9. Network and database access security is required and that is most important

8(b)

Central Government is empowered to impose 'Safeguard Duty' on specified imported goods. It comes when the Central Government is satisfied that the goods are being imported in large quantities and under such conditions that they are causing injury to the domestic industry. Such duty is permissible under the WTO Agreement. The only condition under the WTO is that it should not discriminate between imports from different countries having Most Favoured Nation (MFN) status.

'Safeguard Duty' is a step in providing a need-based protection to domestic industry for a limited period for restoring free and fair competition within the domestic market. 'Safeguard Duty' is targeted at remedying or preventing serious injury to the domestic industry with a view to making it competitive and to enable it to stand on it's own.

The Central Government has to conduct an enquiry and then issue a notification. The 'safeguard duty' is valid for four years unless revoked earlier. This can be extended by Central Government but the total period of 'safeguard duty' cannot be for more than ten years. This duty is in addition to any other customs duty being imposed on the goods. In case of imports from developing countries, such 'safeguard duty' can be imposed only if import of that article from that country is more than 3% of total imports of that article in India.

8(c) Due Diligence' primarily means "background checking" or examination of a target asset for an acquisition by a prospective buyer. It is the performance of an act with certain standard of care and caution/precaution to protect the health. It is described as fact-finding to assist in taking the final decision whether to buy the target asset or how much to be offered for the acquisition. The main objective of 'Due Diligence Audit' is to verify the correctness of the data disclosed by seller to identify if any material fact that may not have been disclosed by the seller. In a nutshell, the buyer determines through 'Due Diligence Audit' that the proposed bought out acquisition contains all the assets and liabilities that have been paid for.

Although 'Due Diligence Audit' varies in each case based on its own merit but the broad areas of investigation include finance, legal, personnel, taxation, environmental and other market and commercial considerations.

A comprehensive Due Diligence Audit involves the investigation in the field mentioned below.

1. Compatibility audit
2. Financial audit
3. Macro environmental audit
4. Marketing audit
5. Production audit
6. Management audit
7. Information system audit
8. Legal environmental audit
9. Reconciliation audit