

FINAL EXAMINATION

GROUP IV

(SYLLABUS 2016)

SUGGESTED ANSWERS TO QUESTIONS

JUNE 2019

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.

All Sections are compulsory. Each Section contains instructions regarding the number of questions to be answered within the Section.

All working notes must form part of the answers.

Wherever necessary, candidates may make appropriate assumptions and clearly state them.

Section-A (20 Marks)

Section-A contain question number 1.

All parts of this question are compulsory

1. Choose the correct option from amongst the four alternatives given (1 mark is for the correct choice and 1 mark is for the justification/workings): 2x10=20
- (i) ORS Ltd. is a multi-product company having annual turnover of ₹103 crore, Table A items under CARO being ₹26 crore, Table B items ₹8 crore and the rest are not covered in either of the Tables. Cost Audit will be _____ .
- (A) not applicable to the company
- (B) applicable for Table A products only
- (C) applicable for all products
- (D) applicable for Table A and Table B products only

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- (ii) The wages of employees of contractor engaged in the organization for the past period is _____ Employee Cost.
- (A) included in
 - (B) excluded from
 - (C) included to the extent of statutory contribution of employer
 - (D) partly included
- (iii) The Cost Accounting Standard 24 is a Cost Accounting Standard on _____ .
- (A) Overburden Removal Cost
 - (B) Royalty and Technical Know-how Fee
 - (C) Treatment of Revenue in Cost Statements
 - (D) Selling and Distributions Overhead Cost
- (iv) The figures below are available for Reliable Ltd. Budgeted production - 800 units, Standard hours per unit 25, Actual production 576 units and actual working— 12000 hours. What is the Efficiency Ratio?
- (A) 110%
 - (B) 120%
 - (C) 100%
 - (D) 125%
- (v) Machinery used in defense, space and atomic energy sector and fulfilling turnover criteria is under
- (A) regulated sector.
 - (B) unregulated sector.
 - (C) exempted by different statute.
 - (D) not applicable category.
- (vi) Cost Auditing Standard 102 deals with _____ .
- (A) knowledge in performing of audit of cost statements, records etc.
 - (B) ensuring conduct of audit of cost statements
 - (C) planning on audit of cost statements, records etc.
 - (D) documentation of audit of cost statements, records etc.
- (vii) The abridged cost statement (CRA 3) need not be separate for
- (A) each product with separate (CTA) CETA heading
 - (B) each product having separate industry specific expenses
 - (C) each product having different unit of measure
 - (D) self/captive consumption of each product

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- (viii) The Management Auditor should evaluate MIS of an organization after _____ .
- (A) studying content, quality and source of information
 - (B) studying flow of information
 - (C) studying correlation of information in decision areas
 - (D) studying all the above
- (ix) Operational Audit can lead to better management with the focus on
- (A) transaction based analysis for fraud prevention.
 - (B) compliance of Rules.
 - (C) risk identification, process improvement.
 - (D) budget monitoring.
- (x) The first step in audit of Educational Institutions —
- (A) Read through the minutes of the meetings of the Managing Committee or Governing Body
 - (B) Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund
 - (C) Verify the annual statement of accounts
 - (D) To examine the Trust Deed or Regulations

Answer:

- (i) (B) (Applicable for Table A products only). Rule 4 to Companies (Cost Audit & Records) Rules, 2014 states that if the overall turnover of the company is more than ₹ 100 crore, only products of Table A will be covered if the sum total of all the products of the company covered under Table A and Table B is more than ₹25 crore but less than ₹35 crore.
- (ii) (B) (Excluded from). CAS 7 on Cost Accounting Standard on Employee Cost excludes benefits paid or payable for the services rendered by employees of any contractor engaged in the organization.
- (iii) (C) (Treatment of Revenue in Cost Statements). The objective of CAS-24 is to bring uniformity and consistency in the principles and methods for treatment of revenue in cost statements with reasonable accuracy.
- (iv) (B) $(120\%) \text{ Efficiency Ratio} = \frac{\text{Actual output (576 units)}}{\text{Standard output (12000 hours/25 hours = 480 units)}}$; therefore, Efficiency ratio = $576/480 = 1.20$ or 120%.
- (v) (B) (Unregulated sector). Machinery used in defense, space and atomic energy sector and fulfilling turnover criteria is under Unregulated sector.
- (vi) (D) (Documentation of audit of cost statements, records etc.) The purpose of the Cost Auditing Standard 102 is to provide guidance to the members in the preparation of audit documentation in the context of the audit of cost statements, records and other related documents.

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- (vii) (D) (Self/Captive consumption of each product). The abridged cost statement need not be separate for Self/Captive Consumption of each product.
- (viii) (D) (Studying all the above). The Management Auditor should evaluate MIS of an organization after studying content, quality and source of information, studying Flow of information, studying correlation of information in decision areas.
- (ix) (C) Risk identification, process improvement. The objective is to assist the organization in performing functions more effectively and economically with focus on the efficiency and effectiveness of operations, giving an early warning system for the detection of potentially destructive problems.
- (x) (D) (To examine the Trust Deed or Regulations). The Trust Deed or Regulation is the basic document on which the composition of the educational institution is framed.

Section-B (80 Marks)

Answer any five questions from question nos. 2 to 8.

Each question carries 16 marks.

2. (a) (i) During the course of audit as Cost Auditor, you have come across (I) some material deficiency and (II) significant variation in material consumption over the previous year. State the provisions of the Companies (Cost Records and Audit) Rules, 2014 in this regard.
- (ii) What is the applicability of Real Estate Development under the Companies (Cost Records and Audit) Rules, 2014? 4+4=8
- (b) (i) ABC Ltd. changed its Stock Valuation Policy from FIFO method to Average Cost method in the FY 2018-19, as a result of which the profit of the Company was inflated by ₹ 25 lakhs. The change in policy and the fact of additional gain were not disclosed by the Company nor the Cost Auditor in the Audit Report. State whether the Cost Auditor is deemed to be guilty of professional misconduct.
- (ii) In the course of performance of his duties, some fraud against the Auditee Company gets disclosed to the Cost Auditor.
- What is the punishment to Cost Auditor for failing to report to the Authority within prescribed time? 4+4=8

Answer:

2.(a)(i)

Pursuant to rule 6(4) of the Companies (Cost Records and Audit) Rules, 2014 read with the Cost Audit Report in form CRA-3, if as a result of the examination of the books of account, the Cost Auditor desires to point out any material deficiency or give a qualified report, he/she shall indicate the same against the relevant para (i) to (vii) in the prescribed form of the Cost Audit Report giving details of discrepancies he/she has come across. The report, suggestions, observations and conclusions given by the cost auditor under this paragraph shall be based

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on verified data, reference to which shall be made here and shall, wherever practicable, be included after the company has been afforded an opportunity to comment on them.

The prescribed format for Cost Audit Report states that 'Wherever, there is any significant variation in the current year's figure over the previous year's figure for any item shown under each para of the annexure to the cost audit Report, reasons thereof shall be given by the cost auditor. Accordingly, any variation in material consumption during current year over the previous year shall be clarified in Part B of Annexure to Cost Audit Report.

2.(a)(ii)

Real Estate Development falls under Construction Industry in the Non-Regulated sector (item 21) and has been defined to be corresponding to para no. (5)(a) as specified in Schedule VI of the Companies Act, 2013. Para (5) of Schedule VI of the Companies Act, 2013 pertains to "Industrial, commercial and social development and maintenance" and covers "real estate development, including an industrial park or special economic zone" as per sub-clause (a). Hence, every construction activity in relation to the above are covered under the Rules. The rule has been made effective from April 1, 2014 and no CETA Heading is applicable for such industry.

The Institute (ICAI) has issued Guidance Note on Maintenance of Cost Accounting Records for Construction Industry including Real Estate and Property Development Activity.

2.(b)(i)

The Second Schedule to the Cost and Works Accountants Act, 1959 stipulates that a Cost Accountant in practice shall be deemed to be guilty of professional misconduct if he

(Item 5) fails to disclose a material fact known to him in a cost or pricing statement but disclosure of which is necessary in making such statement;

(Item7) does not exercise due diligence or is grossly negligent in the conduct of his professional duties;

(Item 9) fails to invite attention to any material departure from the generally accepted procedure of costing and pricing applicable to the circumstances;

In the given circumstances, the Auditor has failed in his duties and is deemed to be guilty of professional misconduct.

2.(b)(ii)

According to Section 143(12) of the Companies Act 2013, if an auditor (Cost Auditor is included) of a company, in the course of the performance of his duties as Auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within such time and in such manner as may be prescribed. Sub-Section 13 specifies that no duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred to in sub-section (12) if it is done in good faith. According to Sub-Section 15 if any auditor does not comply with the provisions of sub-section (12), he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

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3. (a) (i) 'The Cost Auditor should have adequate knowledge of client's business, its process and the business environment' — Making a reference to relevant Cost Audit Standard, discuss the areas which the new Auditor is required to understand.

(ii) LMN Textiles Ltd. purchased a ring frame at ₹ 5 crore and high value spares at ₹ 1 crore, the whole amount being capitalized.

How should high value spares be treated as per CAS 12 when actual replacement takes place (I) with or (II) without reconditioning? 4+4=8

(b) The Cost Accountant of BEELON TEXTILES MILLS LTD. has arrived at a profit of ₹ 22,14,000 based on Financial Accounts for the year ended March 31, 2019.

The Profit as per Cost Accounting records showed a different figure.

As a Cost Auditor, you find the following differences between the Financial Accounts and Cost Accounts:

(i) Profit on sale of Fixed Assets	₹ 2,00,000
(ii) Profit on sale of Investments	₹ 35,600
(iii) Voluntary Retirement Compensation included in Salary & Wages in F/A	₹ 60,31,200
(iv) Donation paid	₹ 80,000
(v) Insurance claim relating to previous year received during the year	₹ 5,08,000
(vi) Profit from retail trading activity	₹ 32,05,400
(vii) Interest income from Inter-Corporate Deposits	₹ 6,10,000
(viii) Goodwill written off in F/A	₹ 4,00,000
(ix) Increase in value of Closing WIP and Finished goods inventory	
as per Financial Accounts	₹ 360,55,000
as per Cost Accounts	₹ 390,15,000

You are required to prepare a Reconciliation Statement between Cost and Financial Accounts and arrive at Profit as per Cost Accounts for the year ended March 31, 2019.

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Answer:

3.(a)(i)

As per Cost Audit Standard 104 on Knowledge of Business, its Processes and the Business Environment, the Cost Auditor should obtain an understanding of the following of the client's business which is sufficient to identify and understand the events, transactions and practices that, in the cost auditor's judgment may have a significant effect on the examination of cost statements or on the preparation of the cost audit report:

- Business processes, major inputs
- Joint & By-Products and Wastages and major outputs etc.

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- The entity's ownership and governance structure.
- Relevant industry, regulatory, and other external factors including the applicable cost and financial reporting framework.
- The entity's selection and application of cost accounting policies.
- The measurement and review of the entity's performance.
- The Entity's Internal Control
- The entity's risk assessment process
- Cost Information System/ Management Information System
- IT (Information Technology) Environment and Control
- Identify and assess the risks of material misstatement at the cost statement level; and at the assertion level
- Documentation: The auditor shall document key elements of the understanding obtained regarding each of the aspects of the entity and its environment specified in paragraph 5.1 & 5.2 of the Standard.

3.(a)(ii)

As per CAS-12 on Repairs and Maintenance Cost, high value Spare, when replaced by a new spare and reconditioned, should be recognized as property, plant and equipment when they meet the definition of property, plant and equipment and depreciated accordingly. Otherwise, such items are to be classified as inventory and recognized in cost as and when they are consumed.

In the present case, the spares if capitalized, should be depreciated over the years. When used as replacement, the depreciated value plus conditioning cost, if any, will be treated as Repair & Maintenance cost, the equivalent value reduced from asset. For example, the spares of initial value of ₹1 crore having life or 10 years would have depreciated value of ₹ 50 lakh. When it is used as replacement, the said ₹ 50 lakh will be treated as Repairs and Maintenance Cost.

3.(b)

STATEMENT SHOWING THE RECONCILIATION OF PROFIT BETWEEN COST AND FINANCIAL ACCOUNTS AND PROFIT AS PER COST ACCOUNTS FOR THE YEAR ENDED MARCH 31, 2019

	₹	₹
Profit as per Financial Accounts:		22,14,000
Add: Voluntary Retirement compensation included in salary and wages in F/A - Not included in cost A/c	60,31,200	
Add: Donation paid	80,000	
Add: Goodwill written off in F/A- not considered in Cost Account	4,00,000	<u>65,11,200</u>
		87,25,200

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Less: Profit on Sale of Fixed Assets-Not considered in cost A/c	2,00,000	
Less: Profit on sale of investment- not considered in cost A/c	35,600	
Less: Receipts of insurance claim related to previous year-Not considered in cost A/c	5,08,000	
Less: Profit from Retail trading activity- not considered in Cost A/c	32,05,400	
Less: Interest Income from Inter-Corporate deposit- Not considered in Cost A/c	6,10,000	<u>(45,59,000)</u>
		41,66,200
Add: Difference in valuation of stock:		
Increase in inventories as per Cost Accounts	390,15,000	
Increase in inventories as per Financial Accounts	(360,55,000)	<u>29,60,000</u>
Profit as per Cost Accounts		71,26,200

4. (a) 'The need for Productivity/Efficiency Audit has arisen in order to examine effectiveness of resource utilization'.— Explain Efficiency Audit.

Mention how Efficiency Audit can be carried out.

2+6=8

(b) MNP Ltd. appoints you as Management Auditor to check internal system in the area of data processing. List out the areas covered by such study.

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Answer:

4.(a)

The Efficiency audit is basically an analysis of the productivity of the resources deployed by any organization. It is generally done to generate information about the status of productivity in the organization for the purpose of determining the scale of efficiency and effectiveness of 'resource utilization'. The term 'resources' here would include not only "money" but also "men", "machines", "materials" and "methods". In other words, the objectives of productivity audit is (a) to attain optimum result, and (b) to improve on the benchmarks. Efficiency audit would generally comprise -

- a. comparison of expected returns on utilization of the resources vis-a-vis the actual returns;
- b. comparison of optimum returns on utilization of the resources vis-a-vis the actual returns;
- c. the steps taken to improve benchmarks of returns and the utilization.

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The efficiency audit is actually "productivity of every resource employed". The tools used for such audit are -

- a. (i) Ratio analysis - Return on capital employed - Return on sales - Turnover ratios of fixed assets, current assets, inventories, category-wise debtors etc. (ii) Capacity utilization of plant, machinery and equipment against available capacity.
- b. Productivity analysis of man (labor) hours in time and cost.
- c. Material consumption against norms and benchmarks.

4.(b)

The study on data processing need emphasize economy, secrecy and prompt reporting. The questions which be put before the Management relating to present vis a vis an efficient system are summarized below:

- a. What are the level of data processing and e-governance in the organization?
Has the right balance between such methods being achieved over all?
- b. Are the job done by people within or is outsourced?
- c. Are computer systems used where appropriate, compatible with the software installed.
- d. Is the computer installation appropriate in size, workload and staffing?
- e. What control is exercised on input to an output from the computer installation, and if by a control system is this sufficiently independent?
- f. What are the hierarchies who have access to the computer installations?
- g. How is the amendment/upgradation of such program controlled?
- h. Does the systems testing cover operating systems, files management, operation messages, data management, job control routines and fault detection?
- i. Are cloud computing and other sharing of platform are arranged?
- j. If so, is the cost justified by the extent of the utilization of the main computer on other data processing?
- k. Is there full documentation of all programs and systems with adequate back up?
- l. Is the system security protected by efficient and renowned agencies?

5. (a) (i) The Audit Committee of STR Ltd. has outlined you to cover as Internal Auditor in the area of asset safeguarding of the Company. How you would proceed?

(ii) State whether a private company is liable to appoint Internal Auditor. Will the answer differ if the share capital of the company was more than ₹ 1 crore? 6+2=8

(b) Briefly discuss the Internal Audit program of Non-Government Organization. 8

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Answer:

5.(a)(i)

For effectiveness of internal control, the scope of Internal Auditor's work is outlined by the Audit Committee of the Board of Directors. Apart from any direction in general or in case there is no Audit Committee, the scope of Internal Auditor's work must make a review of:

- Internal control system and procedures- if there is no Audit Manual, design the same.
- System regarding custodianship and safeguarding of assets Fixed and Current;
- Compliance with various policies, plan and procedure by the different productive and service units, at different hierarchies of Management,
- System of collection of data- both monetary and non-monetary, to ensure that the information given to management is relevant and reliable.

For safeguarding of Assets, a study on asset protection measure be taken to prevent the assets from theft, burglary, fire, electric and other hazards. This includes obsolete and non-performing assets which should be removed or replaced. For immovable property, steps be taken to prevent encroachment or illegal occupation. Proper insurance of the assets be made and the insurance Matters should cover:

- Examination of Policy Coverages-whether all types of Assets are covered.
- Examination of Adequacy of Policy Coverages; -whether the value covered covers its costs.
- Insurance Claims & Realization of Insurance Claims;
- Scrutiny of Records pertaining to Insurance Claims;
- Review of Status of outstanding claims.
- Whether guideline issued by the Insurance Authority is followed so that the claim is not nullified due to lapses on the part of the Company.

5.(a)(ii)

As per sec. 138 of the Companies Act, 2013 read with Rule 13 of Companies (Audit and Auditors) Rules, 2014, every private company shall be required to appoint Internal Auditor or a firm of Internal Auditor having

- (i) Turnover of two hundred crore of rupees or more during the preceding financial year;
- (ii) Outstanding loans or borrowings from Banks or Financial Institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

The applicability of appointment of Internal Auditor by a private company is not dependent on the criteria of equity capital.

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5.(b)

While planning the audit of a Non-Governmental Organization (NGO), the auditor may concentrate on the following;

- i. Knowledge of the NGO's objective, its mission and vision, areas of operations and environment in which it operates.
- ii. Reviewing the legal form of the organization and its Memorandum and Articles of Association, rules and Regulations.
- iii. Reviewing the NGO's Organization chart, Financial and Administrative Manuals, Project and Program Guidelines, Funding Agencies Requirements and Formats.
- iv. Examination of minutes of the Board/Managing Committee/Governing Body/Management and Committees thereof to ascertain the impact of any decisions on the financial records.
- v. Study the accounting system, procedures, internal controls and verify their applicability.

The audit program should include in a sequential order all assets, liabilities, income and expenditure ensuring that no material is omitted, details vouched and/ or checked particularly in the following heads:

- (i) Corpus fund
- (ii) Reserves
- (iii) Ear-marked Funds
- (iv) Project/Agency Balances
- (v) Loans
- (vi) Investments
- (vii) Cash in Hand
- (viii) Bank Balance

6. (a) The following is the abridged comparative Balance Sheets of PRAVISH LTD, a consumer products manufacturing company for two years as on March 31, 2019 and 2018:

(Amount in ₹ Lakh)

	2019	2018
Equity & Liabilities		
Shareholders' Fund:		
Equity Share Capital	3,500	2,000
Reserves and Surplus	3,800	3,000
Non-Current Liabilities:		
Term Loans	3,000	1,500
Debentures	1,500	1,500

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Other Long-term Loans	1,200	1,500
Current Liabilities:		
Current Liabilities	2,600	1,200
Short-term Provisions	860	652
Total	16,460	11,352
Assets		
Non-Current Assets:		
Fixed Assets:		
Tangible Assets	4,000	3,800
Intangible Assets	—	—
Capital Work-in-Progress	1,700	—
Non - Current Investments:		
Investment in subsidiaries	800	400
Current Assets:		
Inventories	3,930	2,090
Trade Receivables	4,810	3,258
Cash and Cash equivalents	600	404
Short-term Loans and Advances	620	1,400
Total	16,460	11,352

Additional Information:

(₹ in Lakh)

Year ended March 31	2019	2018
Profit before Tax (PBT)	1,300	1,150

You are required to compute the following as stipulated in PART-D, PARA-4 to the Annexure of Cost Audit Report under the Companies (Cost Records and Audit) Rules, 2014 for the year ended March 31, 2019:

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

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- (b) The bio-gas produced from wash of alcohol in KLM Industrial Alcohol Ltd. is used as a supplement with fuel oil in generating steam. The steam is used in steam turbine for production of power and the exhaust of steam turbine is recycled for manufacture of alcohol. In process, the fall in enthalpy (heat content) value of the steam is 10%. The following details are extracted from the Cost Accounting records of the Company for the year ended March 31, 2019:

	Boiler (₹)	Turbine (₹)
Cost of Water	6,80,000	
Fuel Oil	6,00,00,000	
Bio-gas plant expenses	1,68,00,000	
Stores and Chemicals	1,80,000	
Salaries and Wages	20,00,000	4,80,000
Repairs and Maintenance	44,00,000	1,80,000
Depreciation	12,00,000	4,40,000
Other expenses	26,00,000	80,000
High pressure steam Generated (MT)	24,000	
Power Generated (KWH)		18,00,000

Required:

Prepare two Cost Sheets for steam and power as per CAS-8 on cost of utilities for the yearended March 31, 2019. 8

Answer:

6.(a)

PRAVISHLTD.

(Amount in ₹ Lakh)

Year ended March 31	2019	2018	2019	
(i) CAPITAL EMPLOYED:				
Total Assets	16460	11352		
Less: Investment in Subsidiaries	800	400		
Less: Current Liabilities	3460	1852		
Less: Capital work in progress	1700	-		
	10500	9100		
Average capital employed for the year ended March 31 $(10500+9100)/2$			9800	
(ii) NET WORTH:				
Share Capital			3500	
Reserves and surplus			3800	
			7300	

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(iii) PBT to Capital Employed	(1300/9800)		13.27%	
(iv) PBT to Net Worth	1300/7300		17.81%	
(v) Debt- Equity Ratio	5700/7300		0.78:1	
(vi) Current Assets to Current Liabilities	9960/3460		2.88	2.88:1

Working Notes:

		(₹ In lakh)		
(i) Debt:		₹	(iii) Current Liabilities:	
Term loans	3000		Current Liabilities	2600
Debentures	1500		Short Term Provisions	<u>860</u>
Other long Term Loan	<u>1200</u>			<u>3460</u>
	<u>5700</u>			
(ii) Current Assets:				
Inventories	3930			
Trade Receivables	4810			
Cash and cash equivalents	600			
Short term loans & advance	<u>620</u>			
	<u>9960</u>			

6. (b)

Cost Sheet of Steam For the year ended March 31, 2019

Generation : 24,000 MT	(₹ 000)	Unit cost/MT ₹
Cost of water	680	28.33
Fuel Oil	60,000	2,500.00
Biogas plant expenses	16,800	700.00
Stores, chemicals	180	7.50
Salaries, wages	2,000	83.33
Repairs, maintenance	4,400	183.33
Depreciation	1,200	50.00
Other expenses	2,600	108.33
Total	87,860	3,660.83

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Cost Sheet of Power (generated) from Steam turbine For the year ended March 31, 2019

Generation : 18,00,000 Kwh	(₹ 000)	Unit cost/Kwh ₹
Cost of Steam	87,860	48.81
Salaries, wages	480	0.27
Repairs, Maintenance	180	0.10
Depreciation	440	0.24
Other expenses	80	0.04
Total	89,040	49.47
Less: credit for exhaust steam 90%	80,136	44.52
Cost of power used in manufacture	8,904	4.95

7. (a) The following parameters are extracted from the Cost Accounting records of MAHAWISH LTD., a multiproduct manufacturing Company:

(Amount in ₹ Million)

Year ended 31st March	2019	2018
Net sales	3,600	2,880
Other Income	225	150
Increase in value of stock of Finished Goods	15	7
Raw materials consumed	1,320	1,080
Direct Wages, Salaries, Bonus, Gratuity etc.	330	264
Power and Fuel	180	144
Stores and Spares	120	105
Local Taxes	90	75
Other manufacturing Overheads	322	278
Administrative Overheads:		
Audit fees	27	22
Salaries and Commission to Directors	36	30
Other Overheads	195	165
Selling and Distribution Overheads:		
Salaries and Wages	27	23
Packing and Forwarding	15	12
Other Overheads	188	150

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Total Depreciation	90	90
Interest Charges:		
On Working Capital Loans from Bank	45	37
On Fixed Loans from SBI	68	53
On Debentures	22	22
Provision for Taxes	237	150
Proposed Dividends	315	172

You are required to calculate the following as stipulated PART-D, PARA-3 of the Annexure to Cost Audit Report under the Companies (Cost Records and Audit) Rules, 2014 for the year ended March 31, 2019 and March 31, 2018:

- (i) Value Addition
- (ii) Earnings available for Distribution
- (iii) Distribution of Earnings to the different claimants. 10

- (b) During the period 16.08.2018 to 29.08.2018 (two weekly off in between), the manufacturing unit of CDE Ltd. had to be closed down due to a widespread agitation on job reservation by a community of the State. The workmen demanded full wages but it was negotiated to (i) they will work on weekly off on three chosen weeks without overtime and (ii) the rest will be with no wages for direct workers and adjusted against eligible leave for staff and indirect employees. The normal working of the unit is on all days except 52 weekly off and 11 statutory Holidays. The details of the expenses incurred for the year ended March 31, 2019 are as follows:

(Amount in ₹ Lakh)

Indirect/Fixed Cost	Whole Year
Indirect Wages and Salaries	675
Power, Boiler, Security partly used during closure	10
Depreciation	355
Other Fixed Expenses	538
Total:	1,578

Required:

Calculate the abnormal cost for exclusion from the Product cost.

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Answer:

7. (a)

MAHAWISHLTD.

CALCULATION OF VALUE ADDITION

(Amount in ₹ Million)

Year ended March 31,	2019	2018
VALUE ADDITION:		
Net Sales	3600	2880
Add: Export Incentives	-	-
Add/Less: Adjustment in Finished stocks	15	7
	3615	2887
Less: Cost of bought out input:		
(i) Cost of Raw materials consumed	1320	1080
(ii) Consumption of stores and spares	120	105
(iii) Power & Fuel	180	144
(iv) Other overheads (322+27+195+15+188+45)= 792 (278+22+165+12+150+37)= 664	<u>792</u>	<u>664</u>
Total cost bought out input	<u>2412</u>	<u>1993</u>
(i) VALUE ADDED	1203	894
Add: Other Income	225	150
Add: Extra Ordinary Income	<u>0.00</u>	<u>0.00</u>
(ii) Earnings Available for distribution	<u>1428</u>	<u>1044</u>
(iii) Distribution of earnings to:		
(1) Employees as salaries and wages, bonus, gratuity etc.	357	287
Directors- Salaries and Commission	36	30
(2) Shareholders as dividend	315	172
(3) Company as retained funds (including depreciation)	303	255
(4) Government as taxes		
Local Taxes:	90	75
Income Taxes	<u>237327</u>	<u>150225</u>

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(5) Providers of Capital/Fund as Interest:		
Interest on debentures	22	22
Interest on Fixed loans from SBI	6890	5375
Total distribution of earnings	1428	1044

7. (b)

Abnormal cost due to closure abnormally is not included in the cost production. In the given case, CDE Ltd has normal working of $(365-52-11=)$ 302 days. The abnormal stoppage consisted of $(16/8/18- 29/8/18 = 14-2 =)$ 12 working days less 3 compensatory working days i.e. 9 working days. The percentage of abnormal loss comes to $(9/302 =)$ 3% approximately.

Amounts ₹ Lakh

	Whole Year	Closed period
Indirect Wages & Salaries	675	20
Power etc. used during closure	excluded	10
Depreciation	355	11
Other Fixed Expenses	538	16
Total Abnormal Cost during closure		57

8. Answer any four out of the following five questions:

4x4=16

- (a) Explain 'Professional Judgment' and 'Professional Skepticism' as per Cost Audit Standard 103.
- (b) Draw an Internal Audit program on Wage Audit.
- (c) What are the Functions of Management Audit?
- (d) A company bought a new technology for its auto component unit for two products A and B. The condition was to pay a lump of ₹10,00,000 (equally distributable for both products having a service life of 5 years) and Royalty of ₹3 per unit produced. The vendor's technicians were to be paid travelling expenses for maintenance. The company incurs cost for software services and interest for borrowing of ₹1,20,000.

The following information is extracted from the Books of the Company for the year ended March 31, 2019:

Particulars	Product A	Product B
Unit produced (Qty.)	30000	25000
Royalty paid on production (₹)	3/unit	3/unit

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Travelling charges (₹)	10,000	10,000
Software services charges (₹)	24,000	20,000
Hire charges for special equipment (₹)	8,000	—
Interest on Bank borrowing (₹)	60,000	60,000

You are required to compute the Direct Expenses — keeping in view of CAS - 10.

- (e) NAVITA LTD., a Manufacturing company provides the following extracts of raw materials from its records for the year ended March 31, 2019:

	₹
Opening stock of raw materials (6000 units)	2,16,000
Purchase of raw materials (21000 units)	8,40,000
Closing stock of raw materials (4000 units)	—
Freight Inwards	1,02,000
Self-manufactured Packing material for purchased raw materials	70,000
Demurrage charges levied by transporter for delay collection	14,000
Normal loss due to shrinkage 2% of materials	—
Abnormal loss due to absorption of moisture before receipt of materials — (150 units)	—

You are required to calculate the value of Closing Stock of raw materials using Average Cost Method.

Answer:

(a)

Cost Auditing Standard 103 defines 'Professional Judgment' as the application of relevant training, knowledge and experience, within the context provided by cost accounting standards and ethical requirements in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement. The cost auditor shall have an understanding of the entire text of the Cost Auditing Standard, including its application and other explanatory material, to understand its objectives and to apply its requirements properly. In exceptional circumstances, the cost auditor may apply for Professional Judgment, if necessary, to depart from a relevant requirement in a Cost Auditing Standard.

As per Cost Auditing Standard 103, the term 'Professional Skepticism' is an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatements due to error or fraud, and a critical assessment of audit evidence. An attitude of professional skepticism is necessary throughout the cost audit process for the auditor to reduce the risk of overlooking unusual circumstances, of over generalizing when drawing conclusions

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from cost audit observations, and of using faulty assumptions in determining the nature, timing and extent of the cost audit procedures and evaluating the results thereof. When making inquiries and performing other cost audit procedures, the cost auditor should not be satisfied with less-than-persuasive audit evidence based on a belief that management and those charged with governance are honest and have integrity.

(b)

An audit program is a detailed plan of the auditing work to be performed, specifying the procedures to be followed in verification of each item and the financial statements and the estimated time required. To be more comprehensive, an audit program is written plan containing exact details with regard to the conduct of a particular audit. It is a description or memorandum of the work to be done during an audit.

In Wage Audit program, the first step is to define a checklist of records that need to be verified. The Internal Audit program on Wage Audit should mainly focus on verification of

Wage Audit	Staff allotted	Time taken
Attendance records		
Job card records, engagement letter		
Wage agreements, pay scale, increment orders		
PF, ESI and Leave records		
Overtime, Incentive, Production Bonus calculations		
A comparison of total wage bill for previous period		
Vouching of sample calculations.		

The work may be allocated to audit assistant on suitable basis. The Auditor may devise a mechanism to record the progress of work done, modify the program where necessary.

Alternative answer:

An audit programme is laying down the path in its required details before conducting such audit. it is a detailed plan of the auditing work to be performed, specifying the procedures to be followed in verification of each item and the financial statements and the estimated time required. To be more comprehensive, an audit programme is written plan containing exact details with regard to the conduct of a particular audit. It is a description or memorandum of the work to be done during an audit.

In Wage Audit Programme, the first step is to define a checklist of records that need to be verified. The Internal Audit programme on Wage Audit should mainly focus on verification of:

- Payroll package is properly updated with employee's details and it is properly functioning.
- Take out the list of employees for the purpose of verification that no entry is bogus i.e., Ghost Worker.

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- Ensure that all wage payments are made through banks.
- Where payment is made in cash, whether it is done in presence of responsible officer.
- Cross verify wage with some employees, so that there will be assurance with system.
- Checking of Daily Attendance Sheet, Absenteeism Statement, Manpower Planning and Deployment.
- Checking of Employee Signature at the time of payment in case of cash payment and Attendance Register.
- Checking of Appointment/Retirement records of Employees.

The work may be allocated to audit assistants on suitable basis. The Auditor may devise a mechanism to record the progress of work done, modify the programme where necessary.

(c)

FUNCTIONS OF THE MANAGEMENT AUDIT:

The functions of Management Audit extend to audit of the effective functioning of every area of operations coming under the management purview from the stage of its planning to proper implementation and execution. Every manufacturing or service organisation could broadly be identified into the following functional areas:

- (i) Marketing, including selling and distribution
- (ii) Manufacturing/servicing, including maintenance of supply chain, machinery and equipment etc.
- (iii) Human resource management from selection to recruitment, training, motivating, retaining, advancement, etc.
- (iv) Personnel policies and industrial relations
- (v) Finance including maintenance of accounts and providing accounting information to guide the management of its performance and position.
- (vi) Research and Development including application research and basic research, if any.

An understanding of the objectives of each functional area at every level of the organisation and effectively achieving such objectives shall be the prime responsibility of management. Checking of such effective achievement is the function of management audit.

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(d)

Computation of Direct Expenses (as per CAS-10)

(Amount in ₹)

	Product A	Product B
Amortized cost for Technical knowhow	1,00,000	1,00,000
Royalty paid on Units Produced	90,000	75,000
Hire charges of equipment used in A	8,000	—
Travelling Expenses	10,000	10,000
Software services	24,000	20,000
Direct Expenses	2,32,000	2,05,000

N.B. Interest on bank borrowing shall not form part of Direct Expenses.

(e)

Computation of Value of Closing Stock of Raw Materials (Average Cost Method)

	Particulars	Qty (Units)	Amount (₹)
	Opening stock of Raw Materials	6000	2,16,000
Add	Purchase of raw materials	21000	8,40,000
Add	Freight inwards		1,02,000
Add	Demurrage charges levied by transporter for delay in collection		14,000
			11,72,000
Less	Abnormal loss of raw materials (due to absorption of moisture before receipt of materials = $[840000+102000+14000] \times 150 / 21000$)	(150)	(6,829)
Less	Normal loss of materials due to shrinkage during transit [2% of 21000 units]	(420)	0.00
Add	Cost of self-manufactured packing materials for purchased raw materials only		70,000
	Cost of Raw Materials	26430	12,35,171
Less	Value of closing stock $(1235171) / (6000+21000-420) \times 4000$	4000	1,85,880
	Cost of Raw Materials Consumed	22430	10,49,291