Paper 17 - Cost Audit and Operational Audit

Section I (Cost Audit)

1 A) Choose the most correct answer among four alternative statements :(Correct answer in **bold**)

i)XBRL is a language based on :

a)XBL family of languages.

b)XRL family of languages.

c)XML family of languages.(Note: XBRL belongs to Extensible Markup Language family. It has been defined specifically to meet requirements of business and financial information.)

d)XGL family of languages.

ii)Costing Taxonomy is best defined as a:

a)Dictionary.(Note: Costing Taxonomy is a dictionary of all cost elements required in cost audit report and compliance report.)

b)Made easy.

c)Tax Ready Reckoner

d)Referencer.

iii)Form I XBRL is used for filing:

a)Compliance Report of a Company

b)Cost Audit Report of a Company.(Note: Form I- XBRL is used for filing Cost Audit Report and Form A- XBRL is used for filing Compliance Report of a company.)

c)Annual Accounts of a Company

d)Annual Report of a Company.

iv)Excisable clearance means :

a) Only sale of goods from factory.

b)Total clearances from factory.(Note: Removal or clearance means transfer of goods from factory after it finished and excisable . Clearance is a time when excise officer can demand his excise duty .)

c)Despatches from bonded warehouse.

d)Removal from godown.

v)Profit reconciliation for the company as a whole is dealt in :

a)Para 17 of the annexure to cost audit report under Companies(Cost Audit Report Rules), 2011.

b) Para 7 of the annexure to cost audit report under Companies(Cost Audit Report Rules), 2011.

c) Para 27 of the annexure to cost audit report under Companies(Cost Audit Report Rules), 2011.

d)Para 8 of the annexure to cost audit report under Companies(Cost Audit Report Rules), 2011.

vi)Ratio analysis under para 9 of the of the annexure to Cost Audit Report under Companies(Cost Audit Report), 2011 to be furnished for:

a)last year only.

b)current year and previous 2 years.

c)current year and previous year.

d)previous three years.

vii)Para 4 of the annexure to Cost Audit Report under Companies(Cost Audit Report), 2011 deals with:

a)Installed capacity and actual production.

b)Capital employed.

c)Wages and salaries.

d)Overheads.

viii)CAS 14 deals with:

a)Cost of service cost centre.

b)Pollution control cost.

c)Employee cost.

d)Repair and maintenance cost.

ix)maximum amount of penalty payable by a Cost Auditor for non compliance with provisions of Cost Audit Report Rules , 2011 is :

a)Rs 50000/-

b)Rs 5000/-

c)Rs 1000/- per day.

d)Rs 500/- per day.

x)As per CAS 8, cost of utilities shall not include:

a)Employee cost.

b)Administrative overheads.

c)Imputed costs.

d)Selling overheads.

B) Fill in the blanks: (**Answer given in bracket in bold**)

i) The Costing Taxonomy and related Business Rules including sample instance documents can be downloaded from the website of-------------(**MCA**/ ICAI**). Note:** The specific links are as follows: **Costing Taxonomy** - http://www.mca.gov.in/Ministry/pdf/Costing_Taxonomy_2012-11-22_v1.0.zip)

ii)The responsibility of creating XBRL document lies with the--------------(cost auditor/**company**. **Note:** Filing the Cost Audit Report in XBRL format with the Central Government is the responsibility of the Cost Auditor.)

iii)-------------------------- shall be strictly in accordance with the notification issued by the Ministry of Corporate Affairs vide S.O. No. 1747(E) dated 7th August 2012.(**"Product or Activity Group classification"**/Company classification)

iv)Para 3 of the Annexure to the Cost Audit Report deals with-------------(Overheads/**Product Group**)

v) Cost Audit was initially introduced in the year ----------------(**1965**/1959) vi)CAS 5 deals with-----------(captive consumption/**equalized cost of transportation. Note:** CAS 4 deals with captive consumption).

vii)Cost Accounting Records Rules were first made for --------------- industry.(jute/**cement**. **Note:** The rules were notified vide GSR 1402 dated 12/9/66.)

viii)-----------------ensures that every rupee invested in capital or other fields gives optimum returns.(Propriety/ **Efficiency. Note:** Propriety ensures appropriateness of expenditure incurred.)

ix)Variances due to abnormal reasons ------------ form part of cost.(will/**will not**. **Note:** This is as per Generally Accepted Cost Accounting Principles.)

x)The forex component of imported material is converted at the rate on --------------------(**date of transaction**/ date of payment. **Note:** This is as per CAS 6 and GACAP)

2)What you understand by the following terms?

A) Full time employment in respect to disqualifications of Cost Auditor.

B) True and Fair Cost of Production.

Ans: A) As per Section 224(1)(B) of Companies (Amendment) Act, 1988 no person can be appointed as cost auditor of a company if he in full time employment .
However the Companies Act does not define the term 'full time employment.

Thus the following guidelines could be helpful:

a)A whole time director of a company appointed under provisions of Section 269 of Companies Act , 1956 or Secretary under provisions of Section 383 A of Companies Act , 1956 may be considered to be in full time employment.

b)Anyone receiving a salary and PF contribution from his employer or getting such other benefits like Bonus, HRA etc. may amount to be in full time employment.

c)A person declaring income under the head 'Salaries' under Income Tax Act may be considered to be in full time employment.

B) The concept of "True and Fair Cost of Production" is used in the context of cost audit wherein the cost auditor has to state whether in his opinion the company's cost accounting records have been kept so as to give a true and fair view of the cost of production, processing and marketing of the product. A cost auditor checks the cost accounting records to verify that the cost statements are properly drawn up as per the records and that they present a true and fair view of the cost of production and marketing of various products dealt with by the undertaking. The following are the relevant considerations in determining whether the cost of production determined by the cost auditor is true and fair:

- Determination of cost following the generally accepted cost accounting principles
- Application of the costing system appropriate to the product
- Materiality
- Consistency in the application of costing system and cost accounting principles
- Maintenance of cost records and preparation of cost statements in the prescribed form and having the prescribed contents
- Elimination of material prior-period adjustments
- Abnormal wastage's and losses and other unusual transactions being ignored in determination of cost.

It as a result of the examination of the books of account, the cost auditor desires to give a qualified report he shall indicate the extent to which he has to qualify the report and the reasons thereof .

3 A) What details are likely to be provided in Reconciliation of Turnover under Para 11 of the annexure to Cost Audit Report under Companies (Cost Audit Report Rules), 2011.

B) In dealing with the financial position of a company as per para 9 of the Annexure to the Cost Audit Report , state your opinion regarding:

i)Is the Capital Employed to be computed as at the beginning of the accounting period or at the end of the accounting period or average of both?

ii)Should investments like National Savings Certificates deposited with Government authorities for Sales Tax, Excise etc. as security be treated as investments outside the business?

iii)How is 'net worth' defined in this para? The para also states "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 would you take care of this provision?

iv)Should the net sales figure include other service charges and jobbing income?

v) In case the financial accounts of the company are yet to be finalized and audited, should the cost auditor provide the data under para 9?

Ans: A)Turn over as per RT-12 represents the value of clearances as per monthly returns which means the assessable value as per Sec 4 or 4(A) of the Central Excise Act, 1944 with Central Excise Valuation Rules, 2000.

The turn over as per financial books normally includes Excise Duty.

Normally Turnover as per Financial Books and Value of clearances as per RT-12 will not match due to:

i)The concept of Turnover booking in the financial books and Value of clearances of goods are different.

ii)The value of inter-factory transfer is not shown as Turnover.

iii) The goods transferred to department etc. will not form part of turnover but in this case whenever goods are actually sold, then turnover is booked in the books of account.

A proper reconciliation of these figures is to be given under para 11 of the annexure to Cost Audit Report. Excerpts of the same is produced below:

F	RECONCILIATION OF TURNOVER	Amount(Rs)
1.	Turnover as per RT 12	
2.	Turnover as per Annual Accounts(Net off Duties & Taxes)	
3.	Difference between (1-2)	
	(Reasons of difference to be stated)	

B) i)Capital employed should be stated as at the close of the accounting period. However it should be stated for Current Year and previous two years.

ii) Such investments are in normal course of business and for the business, therefore these cannot be treated as investments outside the business.

iii)The term 'net worth' has been defined as share capital plus reserves and surplus (excluding revaluation reserve) less accumulated losses and intangible assets. In other words it can be calculated as under:

Share Capital (paid up capital- equity and preference)	**
Add: Reserves and Surplus	**
Less: Revaluation Reserve	**
Less: Intangible Assets	**
Less: Profit and Loss A/c(Debit balance)	**
Less: Misc/ deferred expenditure	**

A reconciliation of net worth in following form may be provided:

Net worth at the beginning of the year	**
Add :Increase in capital	
Add :Increase in reserve	
Less: Decrease in reserves	
Less: Any loss	
Less: Any acquisition of intangible asset	
or incurrence of expenses treating as deferred	

Net worth at the end of the year **

iv)If other service charges and jobbing income are a regular part of the activity and are of material value these can be treated as sales , otherwise not to be so considered.

v)Where the financial accounts have not been finalized at the time of submission of the Cost Audit Report , Cost Auditor may indicate in his report all financial data under para 9 are 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 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.

4 A) Compute the landed cost of material in accordance with CAS 6 on basis following information.

Purchase of Materials $ 50,000 [Forward contract rate $ = 54.40 but $ = 54,60 on the date of importation] ; Import Duty paid Rs.5,65,000; Freight inward Rs.1,62,000 ; Insurance paid for import by road Rs.48,000; Cash discount Rs.33,000; CENVAT Credit refundable Rs.37,000; Payment made to the foreign vendor after a month, on that date the rate of exchange was $ = 55,20.

B) Following data is available for a company relating to the cost of production of a product subjected to Cost Audit. Prepare the Export Profitability Statement to be included in the Annexure to the Cost Of Production of 20,000 units.
Rs.

Sales(local) 18000 units	810000
Sales (export) 2000 units	80000
Material consumed 40 tonnes @Rs. 10 kg.	400000
Imported Component @ Rs. 12/unit	120000
Direct Labour	40000
Factory Overhead	60000
Administrative Overhead	20000
Freight & Packing (local sales)	18000
Packing for export	8000
Handling at port	2000
Opening Work-in-progress	40000
Closing Work-in-progress	20000

Additional Information:

i)Export incentive of 10% on F.O.B is receivables.

ii)Draw Back on duty paid on raw materials and components available on export is Rs. 10000/-

Ans: A) Computation of Landed Cost of Material

	Particulars	Amount (Rs.)
	Purchase price of Material [50,000 x 54.60]	27,30,000
Add	Import Duties of purchasing the material	5,65,000
Add	Freight Inward during the procurement of material	1,62,000
Add	Insurance of the material (In case of import of material by Road / Sea)	48,000
	Total	35,05,000
Less	CENVAT Credit refundable	37,000
	Value of Receipt of Material	34,68,000

Note:

(i) Excess payment made to the vendor due to exchange fluctuation is not an includible cost, hence not considered.

(ii) Though the forward contract rate was $ = 54.40, but the exchange rate on the date of importation is considered. Hence, included in the cost of materials. Accordingly, the purchase cost is computed considering the $ = 54.60.

B) Taking into consideration the requirements under provisions of Cost Audit (Report) Rules, like showing separately local and export sales, with details like quantity, net realization, price per unit, packing charges etc., Profitability Statements have been prepared as follows:

Statement of Cost of Production

Production : 20000 units	Total cost(Rs)	Per unit cost (Rs)
Direct Materials (40000 Kgs . @ Rs. 10 per Kg)	400000	20.00
Imported components(10000 units @ Rs.6/unit)	120000	6.00
Direct Labour	40000	2.00
Prime Cost	560000	28.00
Factory Overhead	60000	3.00
Opening WIP	40000	2.00
	660000	33.00
Less: Closing WIP	20000	1.00
Works Cost	640000	32.00
Administrative Overhead	20000	1.00
Cost Of Production	660000	33.00

Statement of Cost and Profit on Export Sales

Export Sales: 2000 units	Total cost(Rs)	Per unit cost (Rs)
Cost of production	66000	33.00
Export packing	8000	4.00
Handling at port	2000	1.00
(A)Cost of Sales	76000	38.00
Export Sales realisation	80000	40.00
Export incentive @ 10% of F.O.B	8000	4.00
Duty Drawback on components	10000	5.00
(B) Total realisation	98000	49.00
Profit on Export(B)-(A)	22000	11.00

5 A) The Cost Accountant of KBC Ltd. has arrived at profit of Rs. 2045450/-. He found certain differences between Cost and Financial Accounting records. Profit as per financial accounts is Rs.2214185/-. You are required to prepare a reconciliation statement between the two accounts based on following information.

a) Decrease in value of WIP and finished goods :

as per F/A Rs.38465985

as per cost records Rs.39312660

b) Profit on sale of fixed assets Rs.184500

c) Loss on sale of investments Rs.33600

d)VRS compensation included in salaries and wages in F/A Rs.5025000

e) Donation paid Rs.75000

f) Major repairs & maintenance written off in F/A Rs. 3978000

(Amount as per Cost Accounts is Rs. 1825260)

g)Insurance claim relating to previous year received during the year Rs 4287000

h)Profit from retail trading activity Rs.2136900

B) What information are provided in Para 8 of the Annexure to Cost Audit Report under "Value Addition and Distribution Of Earnings" under Companies(Cost Audit Report Rule), 2011?

Ans: A)

Reconciliation of profit between Cost and Financial Accounts

	Rs.	Rs.
Profit as per Financial Accounts:		2214185
Add: Loss on sale of investments	33600	
Add: VRS compensation not included in cost	5025000	
Add: Donation paid	75000	
Add: Part of repairs & maintenance expenses not considered in cost accounts	2152740	7286340
Less:Diff. in valuation of stock (39312660-38465985)	846675	
Less:Profit on sale of asset not considered in cost accounts:	184500	
Less: Receipts of insurance claim related to previous year	4287000	
Less: Profit from trading activity	2136900	7455075
Profit as per Cost Accounts:		**2045450**

B)Para 8 of the Annexure to the Cost Audit Report requires a statement of Value Added and Distribution of Earnings (for company as a whole) to be given in the following format:

Sl. no	Particulars	Current Year	1st Previous Year	2nd Previous Year
	Value Addition:			
1.	Gross Sales(excluding returns)			
2.	Less: Excise duty etc.			
3.	Net sales			
4.	Add: Export Incentives			

5.	Add/Less: Adjustment in Finished Stocks			
6.	Less: Cost of bought out inputs			
	a)Cost of materials consumed			
	b)Process Materials/Chemicals			
	c)Consumption of stores & spares			
	d)Utilities			
	e)Others, if any			
	Total cost of bought out inputs			
7.	Value Added			
8.	Add: Income from any other sources:			
9.	Earning available for distribution			
	B. Distribution of earnings to:			
1.	Employees as salaries and wages, retirement benefits etc.			
2.	Shareholders as dividend			
3.	Company as retained funds			
4.	Government as taxes(specify)			
5.	Others, if any(specify)			
	Total distribution of earnings			

6 A) From the following figures extracted from the financial and cost accounting records, you are required to compute:

i)Value Added.

ii)Ratio of Operating Profit to Sales.

iii)Ratio of Operating Profit to Value Added.

Particulars	Rs. in lacs
Net Sales excluding Excise Duty	42000
Increase in Stock of finished goods	500
Expenses:	
Raw Materials consumed	5200
Packing materials consumed	2400
Stores and spares consumed	1120
Power and fuel	9200
Repairs and maintenance	400
Insurance	240
Direct salaries and wages	960
Depreciation	1770
Interest paid	2796
Factory overhead:	
Salaries and wages	480
Others	500
Selling and distribution expenses	
Salaries and wages	240
Additional sales tax	914
Others	3400
Administration overheads	
Salaries and wages	240
Others	160

B) What are 'waste multipliers' in textile costing? The following are the process wise wastages on inputs in the year 2012-13.

Process	% age of Wastages on Input
Blow Room	9.18
Carding	7.17
Drawing	1.10
Roving(Simplex)	0.30
Ring Frame(Spinning)	7.21
Reeling and Winding	1.50

From the above , calculate the process wise waste multiplier factor.

Ans:A)

Computation of Value Added	**Rs. in lacs**	**Rs. in lacs**
Net Sales+ Increase in Stock of Finished Goods		42500
Less:		
<u>Cost of bought out materials and services:</u>		
Raw Materials	5200	
Packing Materials	2400	
Stores and Spares	1120	
Power and fuel	9200	
Repairs and Maintenance	400	

Insurance	240	
Other factory overhead	500	
Other Selling & distribution overhead	3400	
Other Administration overhead	160	22620
i)Value Added		19880
Composition of Value Added:		
Depreciation		1770
Interest		2796
Additional Sales tax		914
Salaries and wages(480+240+120+120)		1920
Profit before tax(balancing figure)		**12480**
Operating Profit:		
PBT		12480
Interest paid		2796
		15276

ii)Ratio of operating profit to net sales=15276/42000*100=36.37%

iii) Ratio of operating profit to value added =15276/19880*100=76.84%

B) Under Section 209(1)(d) rules for the Textile Industry, processing cost/kg of output is worked out first. These costs are then aggregated to arrive at total yarn cost. This is done by using a factor known as "waste multiplier". Accordingly, waste multiplier is that quantity of output from any process , which will be needed to get one unit of final output.

Process	%age of wastages on input	Net output for 100 units of input	Waste multiplier
Total	-	100	1.3161
Blow Room	9.18	100-9.18=90.82	1.1953
Carding	7.17	90.82-6.51=84.31	1.1096
Drawing	1.10	84.31-0.93=83.38	1.0974
Roving(Simplex)	0.30	83.38—0.25=83.13	1.0941
Ring Frame(Spinning)	7.21	83.13-5.99=77.14	1.0153
Reeling and Winding	1.50	77.14-1.16=75.98	1.0000

Calculation=1/75.98=0.013161.

7 i) What is XBRL?

ii) What are the potential uses of XBRL?

iii) What is the benefit of having cost related data in XBRL format?

iv) What is Costing Taxonomy ?

v) Which companies are required to file Cost Audit Report and Compliance Report in XBRL format and what is the authority for the same?

Ans: i) XBRL (eXtensible Business Reporting Language) is a language based on XML (Extensible Markup Language) family of languages. It is an open standards-based reporting system that is built to accommodate the electronic preparation and exchange of business reports around the world using internet as a medium. It has been defined specifically to meet the requirements of business and financial information.

It enables unique identifying tags to be applied to items of accounting data. The tags provide a range of information about the item, such as whether it is a monetary item, percentage or fraction. XBRL not only allows labels in any language to be applied to items, it also allows the accounting references or other subsidiary information to be added to the tags.

ii) XBRL can be applied to a very wide range of business applications including financial and cost data. XBRL has applications in the following areas:-

- Reporting for internal and external purposes by an entity involving financial and costing data/information.
- Business reporting to all types of regulators, including tax and financial authorities, central banks and governments.
- Filing of loan reports and applications; credit risk assessments.
- Exchange of information between government departments, institutions and banks.

iii) Government and Regulators require cost data of different sectors for policy making. The availability of cost data [without compromising on the confidentiality] in XBRL format enables informed decision making and for sectoral studies.
With full adoption of XBRL, companies would be able to integrate its financial and cost data across its operational areas and exercise better control on its activities.

iv) Costing Taxonomy is a dictionary of all cost elements required in the cost audit report and compliance report. The costing taxonomy contains the properties and interrelationships of all these cost elements for the purposes of capturing the required reporting data in XBRL format.

v) Ministry of Corporate Affairs has mandated filing of the Cost Audit Report and Compliance Report from the financial year 2011-12 onwards (including overdue reports relating to any previous year) by all cost auditors and companies concerned by using the XBRL taxonomy. MCA vide Circular No. 18/2012 dated July 26, 2012, had extended the last date of filing of cost audit reports and compliance reports with the Central Government in XBRL format up to December 31, 2012.

8) Answer the following questions with respect to Companies (Cost Accounting Records)Rules, 2011.

i)Are there any sectors exempted under Companies(Cost Accounting Record)Rules, 2011?

ii) What constitutes the cost records under Rule 2(e)? Whether the format of "Abridged Cost statement" prescribed in the Companies (Cost Audit Report) Rules, 2011 can be considered as a sample cost statement?

iii) For how many years, does a company under these rules require to preserve the Cost details?

iv) A company under Cost Audit maintains its records on standard costing system. Is this acceptable for Cost Audit? What are the requirements in regard to variances and their treatment in cost proformae?

Ans: i)MCA General Circular No. 67/2011 dated 30th November 2011, states that the Companies(Cost Accounting Records) Rules, 2011 are not applicable to wholesale and retail trading, banking, financial, leasing, investment, insurance, education, healthcare, tourism, travel, hospitality, recreation, transport services, business/professional consultancy, IT and IT enabled services, research and development, postal/courier services, etc. Unless any of these have been specifically covered under any other Cost Accounting Records Rules.

ii) Books of account and other records relating to utilization of materials, labour and other items of cost that provides data/information to compute the cost of production, cost of sales and margin of each of the products/activities of the company on monthly/quarterly/half-yearly/annual basis are considered part of the cost records. It includes statistical, quantitative and other records which enable the company to exercise, as far as possible, control over the various operations and costs with a view to achieve optimum economies in utilization of resources. Cost records are required to be maintained on continuous basis from the basic stage of inputs to the final output. There cannot be any exhaustive list of cost records. This would depend on the materiality of cost components in the cost of the product/activity.
The abridged cost statement can be used as a sample cost statement. This may be modified according to the need of the company.

iii)In respect of companies coming under the purview of the Companies(Cost Accounting Records) Rules, 2011 and the Companies(Cost Audit Report) Rules, 2011 for the first time, cost records and cost details , statements, schedules, etc. shall be kept in good order for next eight financial years beginning with first year of application of the said Rules.

iv) Where a company maintains cost records on any basis other than actual such as standard costing , the records shall indicate the procedure followed by the company in working out the cost of the activities and services under the system. The cost variances shall be shown against separate heads and analysed into material, labour, and overheads and further into quantity , price, and efficiency variances. The method followed for adjusting cost variances in determining the actual cost of activities or services should be clearly indicated in cost records. The reasons for variances should also be clearly explained in cost records.

The cost auditor should verify that treatment of variances in cost statements is reasonable and consistently applied. Whether variances are intentioned or not will be a point of specific mention by the cost auditor.

Para 5 of the Annexure to Cost Audit Report furnishing an abridged cost statement (for each product group separately) should reflect figures at actual after adjustment of variances , if any.

9) Answer the following in respect of Companies(Cost Audit Report Rules)2011.

i) Which companies are not required to file the Cost Audit Report?

ii) Who will certify XBRL filing for Cost Audit Report?

iii) Is Performance Appraisal Report required to be filed with the Central Government as a part of the Cost Audit Report?

iv) If in a company, two different units of measurement are used for the same product group. How to report details about such product groups under the relevant Para of the Cost Audit Report?

Ans: i) All such companies that are NOT covered under the company specific Cost Audit Orders issued prior to 31.3.2011 and/or under the industry specific Cost Audit Order No. 52/26/CAB-2010 dated 2nd May 2011, 30th June 2011 and 24th January 2012 are not required to file Cost Audit Report. However, companies meeting with the threshold limits as prescribed in the relevant Cost Accounting Records Rules 2011 are required to file Compliance Report in the XBRL format.

ii) The Cost Auditor [or the lead Cost Auditor in case the company has more than one Cost Auditors] is required to digitally sign and file the Cost Audit Report for the company as a whole.

iii) As per provisions of the Companies (Cost Audit Report) Rules, 2011, every cost auditor, who submits a cost audit report, is also required to furnish Performance Appraisal Report to the Board/Audit Committee of the company in the prescribed format (Form III). However, this report will not be required to be filed with the Central Government.

iv) If a company has two different units of measurement for the same product group, then details for the same product group are to be reported twice with different units of measurement for all the relevant paras and such details need not be aggregated on the Product or Activity Group Code. In this connection, the notes provided in the notification issued by the Ministry of Corporate Affairs vide S.O. No. 1747(E) dated 7th August 2012 may be referred to.

10 i) Who can be appointed as Cost Auditor?

ii)Who is competent authority in companies to appoint Cost Auditor?

iii)What procedure is required to be followed by a company in respect of appointment of Cost Auditor?

iv)What is the obligation of the cost auditor after receipt of formal appointment letter?

Ans: i) The company required to get its cost records audited u/s 233B(1) of the Companies Act, 1956 shall appoint Cost Auditor as defined Cost Accountant as defined in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 (23 of 1959) and who holds a valid certificate of practice under sub-section (1) of section 6 of that Act and including a Firm of Cost Accountants . However, the cost accountant or partners of a firm of cost accountant should be in whole-time practice and not holding any other employment.

ii) Under the revised procedure, the first point of reference will be the Audit Committee to ensure that the cost auditor is free from any disqualification as specified under section 233B(5) read with

section 224 and sub-section (3) or sub-section (4) of section 226 of the Companies Act, 1956. The Audit Committee should also ensure that the cost auditor is independent and is at arm's length relationship with the company. After ascertaining the eligibility, the Audit Committee will recommend to the Board of Directors for appointment of the Cost Auditor.
In those companies where constitution of an Audit Committee is not required by law, the functions of the "Audit Committee" as per the procedure will be discharged by the "Board of Directors".

iii) The procedure to be followed by company is as follows:

- The Company is required to e-file its application with the Central Government on www.mca.gov.inportal, in the prescribed Form23C within ninety (90) days from the date of commencement of each financial year, along with the prescribed fee as per the Companies (Fees on Application) Rules, 1999 as amended from time to time and other documents as per existing practice i.e.

(a) certified copy of the Board Resolution proposing appointment of cost auditor; and

(b) copy of the certificate obtained from the cost auditor regarding compliance of section 224(1-B) of the Companies Act, 1956.

- After filing the online application by the Company, the same shall be deemed to be approved by the Central Government, unless contrary is heard within thirty (30) days from the date of filing such application.

However, if within thirty (30) days from the date of filing such application, the Central Government directs the Company to re-submit the said application with such additional information or explanation, as may be specified in that direction, the period of thirty days for deemed approval of the Central Government will be counted from the date of re-submission of Form 23C by the Company.

- After obtaining approval of the Central Government (deemed or otherwise), the Company will be required to issue a formal letter of appointment to the cost auditor.

iv) The Cost Auditor is required to inform the Central Government within thirty days of receipt of formal letter of appointment from the Company. Such intimation is required to be done in prescribed e-Form 23 D along with a copy of such appointment.

11) As a Cost Auditor how would you deal with the following?

i) GFI Ltd. , manufacturing Cotton Textile , wrote off in the same year , the expenditure in replacement of Copper Rollers used for printing fabrics and Stainless Steel frames used for Dying Yarn whose life are more than one year.

ii)ABC Ltd manufacturers of cables and conductors , has charged only a portion of administrative overheads to cost of production and balance to cost of sales of its products.

iii)KBC Ltd. does not have a system of internal audit but states that it has introduced adequate internal controls.

Ans: i) As per the Cost Accounting Records(Textiles) Rules , cost of items like Copper Rollers used for printing fabrics and the stainless steel frames used for dying yarn put into use in the relevant year shall be treated as deferred revenue expenditure and spread over the effective life of such items . Thus writing off such items in same year is not correct. Thus Cost Auditor is required to qualify his report.

ii) In case administrative overheads are not analysed separately, these may be apportioned to the cost of production and the cost of sales on some appropriate basis . In the instant case the company is correctly treating the administrative overheads. However, the Cost Auditor should check the following in this connection:

- Apportionment of administrative overheads to cost of production and cost of sales is on appropriate basis; and
- This practice is consistently followed from year to year.

iii) Item (***vi***) of the First Paragraph of the main cost audit report in Form II requires the cost auditor to comment on adequacy of internal audit of cost records. It requires the cost auditor to ascertain and state whether:

- System of internal audit of cost records exists in the company;
- Whether such system is adequate;
- Whether such system is commensurate to the size of the company and nature of its business.

Therefore cost auditor should specifically mention that there is no system of internal audit in the company.

12 A) Compute Employee Cost as per CAS 7 on basis of information given:

Particulars	**Amount(Rs)**
Gross pay(This includes cost of idle time hours paid to employees amounting Rs 25000)	**1020000**
Employer's contribution to Provident Fund(including Rs 2000 as penalty for violation of PF rules)	**100000**
Employee's Contribution to PF	**75000**
Festival bonus	**50000**
Unamortised amount of Employee cost related to discontinued operation	**90000**
Employee training cost	**2,00,000**
Festival advance	**35000**
Depreciation on rent free accommodation given to employees	**100000**
Maintenance charges of the said accommodation	**90000**
Municipal Tax on the said accommodation	**3000**

Bi) What is the effective date for CAS 15?

ii)How would you treat demurrage charges as per CAS 15?

iii) After sales service costs occurs do not form part of Selling overhead under CAS 15. Do you agree?

iv) How would you assign transportation cost relating to distribution as per CAS 15?

Ans: B i)This Cost Accounting Standard shall be effective from the period commencing on or after 1st April 2013 for being applied for the preparation and certification of General Purpose Cost Accounting Statements.

ii) As per CAS 15 relating to Selling and Distribution overheads, any demurrage or detention charges, or penalty levied by transportation or other authorities in respect of distribution activity shall not form part of the Selling and Distribution overhead.

iii)The statement is not correct. Warranty costs and after sales service cost are part of selling overhead as per CAS 15. Cost of after sales service provided in terms of agreement for a class of transactions , shall be determined on rational and scientific basis , net of any recovery on the service.

iv)Transportation cost relating to distribution shall be assigned as per CAS 5(on Equalised Cost of Transportation) , where relevant and applicable.

Ans: A)

	Particulars	Amount(Rs.)
	Gross Pay (net of idle time)=Rs (1020000-25000)	995000
Add	Cost of rent free accommodation (Depreciation +Municipal Tax+ Maintenance Charges)=Rs(100000+3000+90000)	193000
Add	Employer's contribution to PF=Rs(100000-2000)	98000
Add	Festival bonus	50000
	Employee cost	1336000

Note:

i)It is assumed that the entire accommodation is exclusively used by employees. Hence cost of accommodation includes all traceable cost to the cost centre.

ii) Cost of idle time hours is an excludible item.

iii)Penalty paid to PF authorities is not a normal cost , hence excluded.

iv)Festival advance is a recoverable amount, hence not included in employee cost.

v)Employee's contribution to PF is not cost to the employer, hence not considered.

vi)Employee training cost is not an employee cost but an item of overhead.

vii) Unamortised amount of Employee cost related to discontinued operation is not an includible item of cost.

13 A) Enumerate the basis of classification of costs as per CAS 1.

B) What do you understand by the term 'abnormal idle capacity' as per CAS 2?

C) What is meant by stand by utility? What would be the normal capacity of a standby utility under CAS 8?

D) How is cost computed if service is provided by contractors as per CAS 13?

Ans: A)Basis of classification of cost as per CAS 1 are as follows:

i)Nature of expense: Material , labour, expenses.

ii)Relation to object-traceability: Direct, Indirect.

iii)Functions/activities :Production, Administration, Selling, Distribution.

iv)Behaviour : Fixed, semi-variable, variable.

v)Management decision making : Marginal, differential, Opportunity, Relevant, Replacement, Imputed etc.

vi)Production process: Batch, process, contract, Joint, operating, operation .

vii)Time period: Historical, predetermined, standard, estimated.

B) 'Abnormal idle capacity' is the difference between practical capacity and normal capacity or actual capacity utilisation whichever is higher.

Here, **practical capacity** refers to the maximum productive capacity of a plant reduced by the predictable and unavoidable factors of interruption pertaining to internal causes. '**Normal capacity'** refers production achieved or achievable on an average over a period or season under normal circumstances taking into account the loss of capacity resulting from planned maintenance.

C) Any utility created to safeguard against the failure of the main source of inputs. In case of any standby utility the normal capacity will be the same as actual production of the utility.

D) Cost of services rendered by contractors within the facilities of the entity shall include charges payable to the contractor and cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources provided to the contractors for such services.

Cost of services rendered by contractors at their premises shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discount), taxes and duties refundable or to be credited. This cost shall also include the cost of resources provided to the contractors.

14 A) How are Cost Accounting Record Rules different from Cost Accounting Standards?

Bi)How would you treat future remediation or disposal costs under CAS 14 relating to Pollution Control Costs?
ii) What is the difference between Cost Accounting policy and Cost Accounting system as per Companies(Cost Audit Report Rules) 2011?

Ans: A)

Cost Accounting Record Rules	Cost Accounting Standards
Cost Accounting Record Rules are prescribed by the Central Government w.r.t utilization of material, labour or other items other items of cost in respect of a class of companies notified under the provisions of Companies Act, 1956. However, Rule 3(1) of the 2011 Records Rules provides for universal application of these rules with exemption of SMEs and companies governed by special Acts.	Cost Accounting Standards (CAS) are a set of standards designed to achieve uniformity and consistency in cost accounting practices. These are prescribed by Cost Accounting Standard Board(CASB) set up by The ICAI.
Separate Rules are prescribed for each class of industry or product.	CAS on other hand are uniformly applicable to all the units including companies and easier to understand and flexible. The coverage is therefore wider. At present there are 15 Cost Accounting Standards.
Most of the Companies today are multi product organizations where products may be governed by different set of rules. Products under these Rules covered by different set of Rules, makes it difficult for the Companies to comply them.	On other hand CAS will be equally applicable to the companies and all product manufacturers. Therefore many experts are of the opinion that prescription of Cost Accounting through CAS with appropriate compliance audit or disclosure norms may be much more effective and useful than through complicated Cost Accounting Record Rules. Moreover this will bring more numbers of companies under the ambit and will help Govt. to achieve its objectives.

B i)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.

ii) Cost Accounting Policy of a company should state the policy adopted by the company for treatment of individual cost components in cost determination.
The Cost Accounting system of a company, on the other hand, would provide a flow of the cost accounting data/information across the activity flow culminating in arriving at the cost of final product/activity.

15 A) How would you treat the following costs under Generally Accepted Cost Accounting Principles ?

- **i) Material acquired in exchange for other materials.**
- **ii) Employee share options.**
- **iii) Moisture losses in material in transit or storage.**
- **iv) Annual Maintenance Contracts(AMC).**

B)What are the preliminary information you, as a Cost Auditor , will collect from the company which is subject to Cost Audit for the first time?

Ans: A i)Where a material is acquired in exchange for other materials or services supplied, the cost of material acquired is taken as the cost of material supplied or services provided plus other applicable cost such as freight.

For e. g in Paper Industry, bagasse from the Sugar Mills is obtained mills by supplying coal to the sugar mills, in the cost statement , the cost of coal supplied is considered as the cost of bagasse procured.

ii) Cost of employee share options is treated as part of employee cost provided the same is not a notional cost and involves an actual cash outlay.

iii)Since most technical calculations are based on dry weight , it is advisable to account for materials which absorb moisture on a dry weight basis grossing up the rate. Dry weight can be air dry or bone dry. In case of wood used in paper industry, given that wood contains moisture, the rate for wood is accounted on the basis of Air Dry Weight which may be obtained after deducting standard or average moisture contents of such wood. Alternatively it can be accounted on bone dry weight after deducting the entire moisture on actual basis.

iv)It is usual to have Annual Maintenance Contracts(AMC) for specialised equipments particularly electronic equipments subject to sudden failures. These take the form of only servicing or servicing with parts(comprehensive). The AMCs specify the number of routine servicing calls that will be made in a year. Where a single machine is covered by AMC, costs get allocated to that machine. But where a fleet of machines are covered by single AMC, allocation of costs to cost centres can be made on basis of number of machines in each cost centre. Where the machines in various cost centres require different levels of service or vary in cost, a suitable allocation base has to be evolved based on such differences.

B)The following information is generally required from a Company by a Cost Auditor relating to Cost Audit:

I)A brief history of the company and its business activities.

II)Memorandum of Association and Articles of Association.

III)Annual reports and accounts for the last three to five years.

IV)A list including addresses of all factories, branch offices and depots with names of manager-in-charge.

V)Organisation Chart with details of key personnel.

VI)Collaboration agreements, if any , including agreements for payment of royalty.

VII)Details of manufacturing capacity-installed, licences and utilisation of installed capacity for last three years.

VIII)A detailed not indicating the system and procedure followed in –

- Cost department.
- Financial Accounting department
- Purchase, raw materials/packing materials , stores etc
- Time office
- Production and Sales Department
- Management Information System
- Internal audit department

IX) Copies of Budget Manual.

X)Flow charts and description of manufacturing process.

XI)Major raw materials with quantitative details for each; unit of finished output.

XII)Labour incentive schemes , if any.

XIII)Details of budgetary control and stand costing procedure with treatment of variances.

XIV)Copies if industrial licences , if any, issued from time to time.

XV)Periodical reports submitted to Excise and other Government authorities.

Section II(Operational Audit)

16 A) State whether following statements are True or False .Justify your answer.(Answer in bracket in bold)

i)The main emphasis of Management Audit is problem identification rather than problem solving.(**True. Management Audit pinpoints the areas requiring attention of management, it evaluates the existence of well defined objectives , it seeks to review appraise and evaluate the corporate plans and policies based on certain standards of objectivity**.)

ii)Under utilization of capacity has no impact on the Cost of Production of a product.

(**False. Under utilisation of capacity will increase cost per unit of a product because less units have to absolve the cost of facilities utilized**.)

iii)Operational Audit is merely extension of Internal Auditing in operational areas.(**True. Its objective is to assist the organization to perform its functions more effectively and economically with focus on effectiveness of operations**.)

iv)No professional qualification are prescribed for a Management Audit.(**True. Management Audit may be conducted by Company Talent which may include administrative staff / audit committee/officer on special duty or Outside management consultants or both**.)

v)Zero base budget(ZBB) system was modeled by Peter A. Woodcock.(**False. ZBB System was modeled by peter A. Phyrrh.**)

vi) Being stakeholder in the equity share capital of an undertaking, agencies like LIC, UTI and other financial institutions management audit.(**True. Management audit can be conducted by agencies like LIC, UTI and other financial institutions to avoid possible losses arising fro inefficient management**.)

vii) Value addition is the difference between gross sales and the cost of bought out materials and services.(**False. Value addition is the difference between net sales and the cost of bought out materials and services.**)

viii) "Related party transaction" means transfer of resources or obligations among persons having blood relations.(**False**. **It means a** transaction **between two businesses that have a personal or other relationship. For example, a** publicly-traded company **may be inclined to hire a large,** minority shareholder **as a** supplier.)

ix)Interest cost should be included in inventory valuation for purposes of bank audit. (**False. Interest cost is finance cost and to excluded for valuation of inventories**.)

x)The Ministerial Conference shall establish five functional committees for discharge of functions agreed to them under the Multilateral Traded Agreements.(**False. The Ministerial Conference shall establish three functional committees for discharge of functions agreed to them under the Multilateral Traded Agreements. These are (a)Committee of Trade and Development (b) Committee of Balance of Payment Restrictions (c) Committee on Budgets, Finance and Administration.**)

B) Fill in the blanks: (Answer given in bracket in bold)

i)Corporate objectives represent the ----------- for the organization as laid down by itself.(**charter**. **Note:** Corporate objectives are those that **relate to the business as a whole**. They are usually set by the top management of the business and they provide the focus for setting more detailed objectives for the main functional activities of the business.)

ii)Management Audit requires an -------------- approach.(**inter-disciplinary. Note:** Management audit involves multidisciplinary and multidimensional approach and requires systematic and dispassionate review of analysis and appraisal of overall performance .)

iii)Professionally managed organization use-------------------------------- in deciding and determining increments, promotions and other rewards for their employees.(**Performance Appraisal Systems**. **Note:** A performance appraisal is a systematic and periodic process that assesses an individual employee's job performance and productivity in relation to certain pre-established criteria and organizational objectives.)

iv)The two techniques available for Social Cost Benefit Analysis are ---------------- and -------------------.(**UNIDO , Little and Mirrlee's Approach.**)

v)Energy audit means the monitoring of energy efficiency of different------------------ and ---------------in a plant.(**equipment, process. Note:** An energy audit is an inspection, survey and analysis of energy flows for energy conservation in a building, process or system to reduce the amount of energy input into the system without negatively affecting the output(s).)

vi)Activity based costing is extended application of ------------- to activity centres.(**value engineering. Note:** Activity-based costing establishes relationships between overhead costs and activities so that overhead costs can be more precisely allocated to products, services, or customer segments.)

vii) ------------------------is the evaluation of every resources declared in the industry.(**Productivity Analysis. Note:** Productivity analysis refers to the process of differentiating the actual data over the estimated data of output and input measurement and presentation.)

viii)---------------- is transfer of goods to an alien market at a price which is less than the marginal cost of its production in the home country.(**Dumping. Note :** It is an unfair trade practice.)

ix) The Audit Committee shall meet at least -----------a year as per the SEBI listing agreement.(**four times**)
x)CERA Audit is conducted by the organization of ---------.(**C & AG i.e. Comptroller and Auditor General**).

17 A) How should a Cost Auditor evaluate MIS of an organization?

B)Audit and Investigation means the same. Do you agree? Justify your answer.

Ans: A) MIS is an essential managerial tool. It provides for identification of relevant information needs of managers at various levels, collection of data, processing the same to become usable to managers and timely dissemination of processed information to the users to help them to make effective decisions for planning, directing and controlling the respective operations.

A Cost Auditor should take into consideration the following aspects while evaluating MIS of an organization:

I)Content, quality and source of information;

II)Flow of information

III)Correlation of information in decision areas.

These points are discussed in detail in the below:

I)Content, quality and source of information include the following:

a)Whether the information collected is relevant to the decision problem so as to improve the quality of decisions?

b)Whether the reporting of MIS is uniform and regular both for financial and nonfinancial information?

c)Whether the information adequately caters to the needs of the decision makers?

d)Whether unwanted data is included in the information?

e)Whether the manager uses the data effective or merely as a post mortem exercise?

II)Flow of information: A cost auditor has to proceed on the following lines:

a)System organization:

- Whether the system is centralized or decentralized?
- How the information flows from various units to the control section?
- Estimating the volume of data involved, transmission time and cost.
- Benefit-cost analysis of centralized vs. decentralized information.

b) Data collection and management: Appraisal includes the following points:

- Data collection methods,
- Filtration and classification of data.
- Matching of data with decision problems.
- Extent of study carried out by management with regard to existing frequency.
- Constraints if any in the system design.

c) Correlation of information in decision areas. The cost auditor is required to appraise this aspect from the following angles:

- Whether input- output analysis is attempted?
- Whether MIS helps in reducing uncertainty?
- Cost effectiveness of MIS.
- Effectiveness of information supplied to users.
- Provision of feedback by MIS for corrective action.
- Ability of MIS to optimize the value of information.

B) Auditing and investigation are largely overlapping concepts because auditing is nothing but an investigation used in a broad sense. Both auditing and investigation are fact finding techniques but their basic nature and objectives differ as regards scope, frequency, basis, thrust, depth and conclusiveness. Audit and investigation differ in objectives and in their nature. Auditing is general while investigation is specific. The object of auditing is to ensure that the books of accounts are free and fair and not misleading or unreliable. The merit of auditing lies in its ability to pronounce in general terms whether the accounts are basically reliable or not and in accordance with the legal requirements and regulations applicable to the particular audit. Audit is not based on suspicion unless circumstances exist to arouse suspicion of the auditor.

Investigation implies systematic, critical and special examination of the records of a business for a specific purpose. The examination conducted under investigation is intensive as well as exhaustive so far as the activities or areas of accounting is concerned. Investigation requires a concentrated focus on the subject matter of inquiry and related matters. Often, investigations may spread over a period longer than one year and its scope may extend to inquiry beyond the books of accounts if the circumstances so require.

18 A) You are appointed by Mr. K who wants to join DEF & Co , partnership firm as an investigating accountant. List out the steps involved in conducting the same.

B) Enumerate some of the areas of concern in an audit of indirect taxes.

Ans: A) The general approach of the investigating accountant in this type of investigation would be more or less similar, irrespective of the nature of business of the firm-manufacturing, trading or rendering a service. Primarily, an incoming partner would be interested to know whether the terms offered to him are reasonable having regard to the nature of the business, profit records, capital distribution, personal capability of existing partners, socio-economic setting, etc. and whether he would be capable for services to be rendered, which can be justified by the overall economic conditions prevailing and other considerations considering his own personality and achievements. In addition, he would be interested to ascertain whether the capital to be contributed by him would be safe and applied usefully. Broadly, the steps involved are as under :

(a) Ascertaining the history of the firm since inception and growth of the firm.

(b) Studies of the provisions of the Deed of Partnership, particularly for composition of partners, their capital contribution, drawing rights, retirement benefits, job allocation, etc.

(c) Scrutiny of the record of profitability of the firm's business over a suitable number of years, with usual adjustments that are necessary in ascertaining the true record of business profits. Particular attention should, however, be paid to the nature and profitability of the business, qualification and expertise of the partners and such others as may be relevant.

(d) Examination of the asset and liability position to determine the tangible asset, partners, investment, appraisal of the value of intangibles like goodwill, knowhow, patents, etc impending liabilities including contingent liabilities and those for pending tax assessment.

(e) Assess position of order at hand and the range and quality of clientle should be thoroughly examined under which the firm is presently operating.

(f) Scrutinise terms of loan finance to assess its usefulness and the implication for the overall financial position.

(g) Study important contractual and legal obligations should be ascertained and their nature studied. It may be the case that the firm has standing agreement with the employees as regards salary and wages, bonus, gratuity and other incidental benefits. Full import of such standing agreements would be gauged before a final decision is reached.

(h) Study the composition and quality of key personnel employed by the firm and any likelihood of their leaning the organisation.

(i) Ascertain reasons for the offer of admission to a new partner and it should be determined whether the same synchronizes with the retirement of any senior partner whose association may have had considerable impact having on the firm's successes.

(j) Appraisal of the record of capital employed and the rate of returns. It is necessary to have a comparison with alternative business avenues for investments and evaluation of possible results on a changed capital and organisation structure.

(k) Ascertain manner of computation of goodwill on admission as also on retirement, if any.

(l) Examine whether any special clause exist in the Deed of Partnership to allow admission in future a new partner.

B) The areas of concern in an audit of indirect taxes would be:

(i) Non availment or short / excess availment of control or expert incentives.

(ii) Goods imported duty free or payment at concessional rates without properly complying with conditions.

(iii) Valuation Issues – valuation not in line with customs rules.

(iv) Applicability of the relevant control excise exemptions.

(v) Valuation of goods not removed in normal course using valuation methods not in line with Central Excise Valuation Rules.

(vi) Ignoring Liability under Service Tax on services provided or availed.

(vii) Procedural non-compliance.

(viii) Passing on of duty suffered on imported goods and of locally manufactured goods in excess of actual.

19 A)Discuss the internal control procedures to be applied in case of Underwriting function.

B) Draft an internal control questionnaire for 'Account Receivables'.

Ans: A) The underwriting function, which comprises of examination and evaluation of applications for insurance, the rating of risks and the establishment of premiums, is fundamental to the operations of a general insurance company. The prime objectives of an internal control system for underwriting is adherence to guidelines for acceptances of insurance, proper recording of insurance risk and its evaluation. The following, therefore, may be the internal control procedures with regard to the underwriting:

(i) Appropriate and clear underwriting guidelines are framed and communicated to the underwriting department and the intermediaries where such guidelines are executed with a reasonable certainty without providing substantial flexibility to the underwriters. The adherence to these guidelines should be monitored by an appropriate official of the company.

(ii) Firm procedures are instituted to ensure adequate investigation of the risks assumed (e.g., medical or other investigative reports are duly obtained from the insured).

(iii) There is an effective communication between claims and underwriting department.

(iv) The relevant information is processed on a timely basis to avoid processing backlogs.

(v) Suspense/unreconciled account balances are reviewed and analysed on a timely basis by responsible officials.

(vi) Guidelines for reinsurance are established and monitored by a responsible officer.

(vii) Adequate systems are developed to identify existence of premium deficiency, if any, and the calculation in respect thereof is regularly performed and approved by an appropriate official.

B) The duties of accounts receivable record keeping should be segregated from the custodial and authorization functions. Further, adequate receivable sub-ledgers should be maintained and reconciled to applicable general ledger accounts . Finally receivables should be aged and reviewed, whereby established procedures should be followed for the collection of past due accounts and subsequent write-off of uncollectible receivables.

The internal control questionnaire for 'Accounts Receivables 'may be drafted as follows:

Questions	Yes	No	N/A	Remarks
1. Are credit and collection and write off policies and procedures current and in writing?				
2.Are these policies and procedures clearly stated and systematically communicated?				
3. Do these policies and procedures support internal control?				
4. Are the responsibilities for maintaining detailed accounts receivable records segregated from collections, disbursement, and general ledger posting functions?				
5. Are disputed liabilities handled by person(s) other than those receiving payment and record keeping functions?				
6. Do controls in the system exist that provide assurances that individual receivable records are posted only from authorized source documents?				
7. Are controls maintained that provide assurances that customer database and, where appropriate, usage records are accurately maintained to ensure that amounts due are billed?				
8. Are billings controlled and properly accounted for?				
9. Is there adequate control over the mailing of statements to prevent interception prior to mailing?				
10. Are statements of account balance mailed on a timely				

basis, where appropriate (for example, in proprietary funds)?				
11. Are aggregate collections on accounts receivable reconciled against postings to individual receivable accounts?				
12. Are all valid receivables promptly recorded?				
13. Is the total of departmental accounts receivable outstanding reconciled to Advance periodically?				
14. Are letters of credit reviewed for accuracy?				
15. Are aged accounts receivable balances periodically reviewed by supervisory personnel?				
16. Do adequate procedures exist for follow-up and collection of delinquent accounts?				
17. Are there controls to insure that individuals with delinquent accounts are precluded from receiving additional credit?				
18. Are delinquent accounts reviewed and considered for charge-off on a timely basis?				
19. Are write-offs or other reductions of receivables, including non-cash credits, credit memos, and allowances, formally approved by senior officials not involved in the collection and recording function?				
20. Do procedures exist that ensure that interest and penalties are properly charged on delinquent accounts?				
21. Are credit balances periodically reviewed?				
22. Does internal control appear adequate for the accounts receivable system overall?				

20) XYZ Ltd. engaged in manufacturing of engineering goods is consistently recording higher sales turnover, but declining net profits since the last 5 years. As an management consultant appointed to find out the reasons for the same, what are the points you would verify?

Ans: As per the facts that there has been consistently high turnover but declining net profits is an anomalous situation. It may be attributed to one or more following reasons requiring further investigation:

(i) *Unfavourable Salesmix*: Where the company sells different engineering products with different product margins, the product with the maximum PV ratio/margin should have a higher share in the total sales. If due to revision of sales mix, more quantities of unprofitable products are sold, profits will be reduced inspite of an increase in sales.

(ii) *Negative Impact of Financial Leverage*: Where the company does not have sufficient own funds (equity) but has a higher debt-equity ratio, the interest commitments will be higher. As the volume of its operation increases, higher debt and interest charges would result in lower profits.

(iii) *Other Items Included in Sales*: The figure of sales as per Profit and Loss Account may include incidental revenues, e.g., freight, excise duty, sales-tax, etc. where the amount of excise duty goes up considerably the total sales may show an increase which is not represented by a real increase in sales quantity/value.

(iv) *High Administrative and Selling Expenses*: Administrative and selling costs are generally period costs which are fixed in nature. Their increase is generally not proportional to sale increase. However, a reduction in profit could also be due to increase in administrative overheads and sales overheads at a rate higher than the rate of increase in sales.

(v) *Cost-Price Relationship*: If the increases in cost of raw materials and labour has not been compensated by a corresponding increase in the sales price this would also result in higher sales and declining profits. Inspite of same sales quantity, for the increasing cost of raw materials and other services, per unit values of the product has been increased which is however unmatched by the increase in cost.

(vi) *Competitive Price*: Where sales have been made at cut-throat prices in order to eliminate competition from the market, the profits would be in the declining trend in the short-run.

(vii) *Additions to Fixed Assets*: Where there are heavy additions to fixed assets and consequent depreciation charges in the initial years of additions, there may be reduction in profits in spite of increased sales.

21 A)Mr . X, newly appointed CEO of ABC Ltd. engages you as a Management Auditor to give him a factual report , as to causes of demoralization of his staff .

B) What do you understand by 'energy audit'? Briefly state the functions of energy auditor.

Ans: **Report on demoralization of Employees:**

The investigation reveals that by and large the employees of the organization are demoralized and dispirited . There is total absence of commitment and initiative on the part of employees. There is a growing discontentment among the employees. The factors responsible for grave demoralization amongst the employees are as follows:

i)Insufficient promotion opportunities : There is no system of 'Individual career growth plan' . Some employees are stagnant and are not getting promotion for long stretch of time. Such employees are totally frustrated and demoralized. A statement of employees stagnating for more than 6 years in the same post may be complied and reason may be looked for.

ii)Preference is given to Direct Recruitment over Internal Promotion. There is no management succession system and no system of 'potential spotting 'amongst employees. Neither the company is serious about training its Human Resources in their functional areas. Direct recruitment to senior staff position is resented to by the employees.

iii) There is considerable imbalance in workload and in overtime opportunities.

iv)There is a system of assignment of personnel to tasks that do not interest/encourage them.

v)There is no 'Employee Participation' in management.

vi)The application of management concepts like 'job rotation' ,'job evaluation', 'merit rating' are totally absent in the organization.

vii)There is no scientific appraisal system. There is favourism and nepotism by the management.

viii)Apart from the above, the human aspects of personnel development viz. the programme of informal education, recreation and culture, community development etc. to enhance the quality of work life are totally neglected.

ix)There is no transfer policy and employees are transferred at the whims and fancies of the management.

So it can be concluded that company is pursuing wrong personnel policies and procedures , leading dissatisfied and demoralized employees.

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

Industrial energy audit is an effective tool in defining and pursuing comprehensive energy management programme.

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

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

(i) Quantification of energy costs and quantities

(ii) To correlate trends of production or activity to energy cost.

(iii) To devise energy database formats to depict to correct picture – By product, department or consumer.

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

(i) To analyse the historical energy consumption and cost data.

(ii) To conduct preliminary energy audit with the objectives to identify:

(a) major energy consuming equipment and process;

(b) obvious inefficiencies and energy wastes; and

(c) priority areas for further detailed investigation.

(iii) To conduct detailed technical and economic analysis of energy efficiency measures involving large efficiency measures involving large capital investment or long payback periods.

22) Explain whether the following amounts to professional misconduct by a Cost Accountant:

i) P , a practicing CMA Q is a practicing Advocate representing matters in courts of law. P and Q agree to help each other in matters involving their professional expertise. Accordingly P recommends Q in all tax litigations in courts of law. Q consults P on all matters relating to costing and related matters, which come to him for arguing in various courts of law. They agree to 'share' the remuneration.

ii) R, a CMA, certifies a financial forecast of his client which was forwarded to the client's bank based on which the bank sanctioned a loan to the client.

iii) Mr. X, a CMA was invited by the Chamber of Commerce to present a paper in a symposium on the issues facing Indian Jute Industry. During the course of his presentation he shared some of the vital information of his client's business under the impression that it will help the Nation to compete with other countries at international level.

iv) A firm of Cost Accountants was appointed by a company to evaluate the costs of the various products manufactured by it for its information system. One of the partners of the firm was a Non-Executive Director of the company.

Ans: i) A CMA in practice shall be deemed to be guilty of professional misconduct if he either directly or indirectly shares commission or brokerage in the fees or profits of his professional business to any other than member of the Institute or accepts any part of the profits of the professional work of a lawyer, broker, etc. who is not a member of the Institute. Thus, as per Clauses 2 and 3 of Part I of the First Schedule to the Cost and Works Accountants Act, 1959 a member in practice can neither share fees or profits with a person who is not a member of the Institute nor he is permitted to receive and share the fees of other such as lawyers, engineers, etc.

P and Q therefore cannot "share" any remuneration. They may, however, remunerate each other for "professional" services rendered on any reasonable basis separately which would be on time basis at rates depending on the extent of expertise. It is, however, important that care should be taken by the member not to extend his service beyond the normal sphere of professional practice and any reports or recommendations should clearly delimit the responsibilities assumed and services rendered.

ii) Under Clause (3) of Part I of Second Schedule to the Cost and Works Accountants Act, 1959, a CMA in practice is deemed to be guilty of professional misconduct if he permits his name or the name of his firm to be used in connection with an estimate of cost or earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast. Accuracy does not refer to arithmetical accuracy. All forecasts are estimates based on certain assumptions duly evaluated on a consideration of various relevant factors and cannot be ascertained with accuracy. . But, first of all, he should clearly indicate in his report the sources of information, the basis of forecasts and also the major assumptions made in arriving at the forecasts and, secondly, he should not vouch for the accuracy of the forecasts. In the instant case, Mr. R is deemed to be guilty as it appears that he has certified the financial forecast without taking adequate safeguards.

iii) Clause (1) of Part I of the Second Schedule to the Cost and Works Accountants Act, 1959 deals with the professional misconduct relating to the disclosure of information by a CMA in practice relating to the business of his clients to any person other than his client without the consent of his client or otherwise than as required by any law for the time being in force would amount to breach of confidence. The Code of Ethics further clarifies that such a duty continues even after completion of the assignment. The CMA may, however, disclose the information in case it is required as a part of performance of his professional duties. In the given case, Mr. X has disclosed vital information of his client's business without the consent of the client under the impression that it will help the nation to compete with other countries at International level. Thus it is a professional misconduct covered by clause(1) of Part I of Second Schedule to the Cost and Works Accountants Act, 1959.

iv) Clause 4 of Part I of the Second Schedule to Cost and Works Accountants Act, 1959 states that expressing an opinion on cost and pricing of any business or any enterprise in which the auditor, his firm or a partner in his firm has a substantial interest would constitute misconduct, unless he discloses the interest also in his report. As per facts of the case, the firm has been retained to evaluate the cost of products manufactured by it for its information system. So this amounts to professional misconduct.

23 A) What is the eligibility criteria to act as Certified Facilitation Centre(CFC) under ACES project?

B) The term 'image' in relation to a company refers to how it is perceived by the public at large .Keeping this in mind how would a management auditor approach to evaluate the corporate image of accompany? Discuss the techniques available to the management auditor to evaluate the corporate image.

Ans: A) A CMA in whole time practice can act as Certified Facilitation Centre(CFC) only after issuance of a Certificate by the Institute(The Institute of Cost Accountants of India). A CFC can be set up and operated by a CMA in whole-time practice who fulfills the following criteria:

a)He/She should be a member of the Institute of Cost Accountants of India and should have valid full time Certificate of Practice issued by the Institute;

b)He/She should possess experience of at least one year in practice;

c)He/She should not have been held guilty of any professional misconduct under the Cost and Works Accountants Act, 1959(as amended) during three years immediately preceding the date of application or violated any law being enforced by the CBEC, as communicated by CBEC to the Institute;

d) He/She should meet technical eligibility criteria for operation of the CFC Scheme .The applicant applying to act as CFC under ACES project must have following minimum physical and technical infrastructure /facilities:

i)Office Space measuring a minimum of 100 sq. ft. and equipped with at least two computer seats for service and 4-5 waiting seats;

ii)Two Pentium Class IV PCs with Colour Monitors and Min. 1 GB RAM, USB Ports, Floppy disk drive and CD Writer;

iii)A desk-jet or laser printer;

iv)A flat bed scanner(above 600 DPI)

v)Broadband Internet connectivity or higher;

vi)Dependable Power Supply arrangements including UPS;

vii)Fax and Phone facility;

viii)A least one trained staff person who can operate the systems;

ix)The Computer system should be equipped with following software:

- Windows 2000/Windows XP
- Web browser IE 6.0 or above, Netscape 6.2 & above
- Adobe Reader V.7.0.5
- Java Runtime Environment(JRE)
- PDF Converter and Anti-virus Software
- HDD 80 GB or more
- MS Excel 2003 or above.

e)He/She should not be facing any investing or enquiry by the CBEC for any violations as communicated by the CBEC to the Institute including the Service Tax Laws and Rules.

B) The steps to be taken by the management auditor are as follows:

i)He should prepare a list of desirable attributes .

ii)The attributes should be classified into main groups and each group dovetailing the specific qualifications.

iii)Weights should be assigned to the atrributes according to relative importance or priority but keeping in mind the aspects of objectivity, relevance, and materiality that might have an impact on image of the corporate sector.

iv)The attributes should then be rated based on facts, judgements and technical studies made by experts in respective fields.

v)The ratings are summarized under the selected groups.

vi)The results are then presented to the management giving a comparative picture between actual and anticipated results.

The techniques available to the management auditor for carrying out corporate evaluations are as follows:

a)Graphical Method: Up-to -date graphs are maintained for each of the attributes of a public under evaluation(i.e. product, consumers, shareholders ,lenders)

b)Point Method: Points are attached to each attribute concerning a profile and scaling them.

c)Index Method: Ideal indices are developed and actual attributes are compared with them.

d)Survey Method: It indicates questionnaires to elicit information.

e)Ratio Analysis: Analysis of events and trends with help of ratios.

f)Position analysis :Position of an enterprise with regard to market size, market share, market stability.

g)Method of comparison: Comparison of actual with budget on quantifiable attributes. It also includes inter-firm comparison within same class of industry.

24) List the task to be performed by CMAs in practice in the following areas:

i) Certifying returns under various ministries.

ii) In Education

Ans: i) **Various Ministries of Government of India have authorised** the Cost Accountants in practice for certifying various returns and to issue compliance certificate as per their formats. Such ministries are Ministry of Finance, Ministry of Commerce, Ministry of Corporate Affairs, Ministry of Chemicals and Fertilizers, Ministry of Textile, Ministry of Consumer Affairs, Food and Public Distribution and gist of the work under them are as follows:

1. Issuance of various certificates under Indian Foreign Trade Policy 2009-14 and Aayat Niryat (Import and Export) Forms (ANF).
2. Certificate of Cost of production of captively consumed goods as per Rule 8 of Central Excise Act, 1944 in accordance with Cost Accounting Standard CAS-4 issued by our Institute.

3. Certificate for Average Cost of transportation as per Rule 5 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000.
4. Certificate towards the amount of duty paid on the materials used for the manufacture of exported goods as indicated in Forms DBK-I,II, IIA,III, IIIA under Customs Act, 1962
5. Issuance of Various Certificates as prescribed by Fertilizer Industry Coordination Committee (FICC) in respect of certifying Cost Data for Subsidy Scheme, Transportation Claims, Escalation Claims and Equalize Freight Claims.
6. Certificate of product wise position of production dispatches stock etc. for the year under FICC.
7. Issuance of Certificates in Form-I to VI as prescribed by National Pharmaceutical Pricing Authority (NPPA), is an organization established by the Government of India to fix/ revise the prices of controlled bulk drugs and formulations.
8. Certificate of fulfillment of Hank Yarn obligation for Textile Industry and Textile Committee Cess- Monthly Return in Form-A.
9. Certifying half yearly return in Form 'N' for Quantity of Rubber purchased & consumed by manufacturers under rule 33 (f) of the Rubber Rules, 1955;
10. Certifying Performa CI & C2 under Anti Dumping as prescribed by Ministry of Commerce;
11. Certifying Statement of cost of production for Anti-dumping petition to Government of India;
12. Certification of Application for License and renewal thereof to act as Surveyor and Loss Assessor under Insurance Regulatory and Development Authority (IRDA)
13. Certification of various forms prescribed under the **Central Electricity Regulatory Commission (CERC);**

ii) University Grants Commission (UGC) has notified "UGC Regulations on Minimum Qualifications for Appointment of Teachers and Other Academic Staff in Universities and Colleges and Measures for the Maintenance of Standards in Higher Education, 2010 vide its Circular No. F.3-1/2009 dated 30th June 2010.
The Regulations prescribe the minimum qualification for appointment of teaching faculty in universities and colleges in the area of Management/ Business Administration. The qualifications specified for appointment of Assistant Professor, Associate Professor and Professor in the above area and Principal/Director/Head of the Institution include First Class Graduate and professionally qualified Cost Accountant among other qualifications and subject to other requirements including qualifying NET/SLET/SET as the minimum eligibility condition for recruitment and appointment of Assistant Professors.

25) You have been appointed as a Management Auditor by KFC Bank. The Bank has recently launched a scheme of 'Gold Card' issuing credit card to all savings account holders with average of Rs 50000/- in the account. How will you evaluate the internal control system in the area of credit card operations of the bank?

Ans: The evaluation of internal control system in the area of credit operations in the bank would have to be done in respect of following aspects:

i. **Segregation of Responsibilities:** The activities relating to credit card operations can be divided in specific areas, namely, beginning from the receipt of application form, evaluating the credit assessment, sanctioning the issuance of card, making and despatch of card would form part one of operations. Later on, particularly, from the accounting view, the significant operations would include receipt of statement from vendors/merchants, raising bills to customers, realisation either by directly debiting the customers' accounts or payment received through cheques, periodic reconciliation, etc. While evaluating internal controls, it would have to be seen that adequate division of responsibilities have been carried out to avoid any collusion and independent checks have been built in the system. While evaluating the internal control, it may also be considered whether some part of the operations have been outsourced or performed in-house.

ii. **Credit Assessment System:** Each application is scrutinised with reference to different parameters for assessing the credit limits to be awarded. The system must be able to generate exception reports at this stage itself. In fact, at the application stage itself, the system must ensure that the applicant was holding one card earlier or has defaulted in respect of any other agency.

iii. **Control Over Issuance of Cards:** The internal control system must ensure that the cards are under the control of responsible official. A detailed record alongwith relevant pin codes, etc. have been kept. See that the system has built-in features that it is almost impossible to make counterfeit cards as also photographs are affixed to prohibit any unauthorised use of the same.

iv. **Reconciling Merchant Records:** It is to be checked whether the system has built-in flexibility of reporting of the payments to be made to merchants and making prompt payment to them. Simultaneously, it should be seen that customer statements are also generated automatically and despatched to them.

v. **Periodic Reconciliation and follow-up:** It may be seen whether periodic reconciliation of customers' accounts is done and regular follow-up of overdue accounts takes place. The person who are responsible for maintaining customers' records are not entrusted with the responsibility of reconciliation and follow-up.

26A) "Much good work gets lost because the auditor's report fails to evoke the interest of the reader". Discuss the above statement in the context of the report of the operational auditor.

B) What is the scope of work for Cost Accountant in Practice as a loss assessor? Give an illustrative list of type of claims and the role of the Cost Accountant in assessing the quantum of loss.

Ans: A) The written report is the medium by which the comments, criticisms and recommendations of an audit work are conveyed to Board and to management in general. It follows ,therefore , that audit reports crystallize the work of the operational auditor and merit the closest consideration of all audit staff engaged in their preparation . Reports must be written with great care after full consideration of the subject matter and with full regard to the fact that it is imperative that the report conveys exactly the right impression on the reader. As the report is the end result of the whole process of auditing, and being the important communication medium , emphasis should be on making it as effective as feasible.

Accordingly, the report of the operational auditor should be backed by logic and facts and figures about operations reviewed by him to management. This is quite pertinent because the objective of conducting the operational audit would be3 achieved only if findings in the report are given attention and implemented to achieve the desired results. Though the fact remains that unless the report contains matters of any worth, mere use of ornamental language is of no value. But the substantial work done by the auditor may totally go waste if the report is not able to hold interest of a reader because it has been drafted in a haphazard manner.

Preparation of an audit report is an art. It should be of such quality that it would keep the interest of the reader alive throughout. Then only the objectives of the report would be met. If the matters reported are just glanced through and brushed off, the whole exercise of the operational audit will be a futile exercise. The objective the management to get an operational audit carried out is to be appraised of the irregularities and deficiencies in the operations and the general state of affairs. The report must be able to meet this requirement. While drawing up a report, consideration must also be given to the level of management at which the report is sent.

Operational audit is a highly analytical task and therefore, there should be support for what is stated in the report. Relevant facts and figures should be provided to enable the reader to assess the reasonableness of the auditor's opinion and to get a ready idea of the implications of the observations of the audit report. The operational auditor should exercise care that matters stated are factually correct and are in clear language . He should have a clear perception of the matters of interest to the management.

In addition to the points already stated, the following points should be considered in drafting a report.
i)The report should be brief, clear and to the point.
ii)The points should be stated in clear cut paragraphs.
iii)Facts should be stated in physical as well as monetary terms wherever possible.
iv)The areas needing improvement should be highlighted as also areas which have shown excellent performance. Stress should be given on items that will improve the operations of the business.

v) As per as practicable, terms and expressions used should be such that they are familiar to the operating people.

vi)The draft report should be discussed with the departmental chiefs in order to have check on accuracy.

The report constitutes a record of matters that were brought to the notice of management, and is a basis for the auditor to follow up matters in a subsequent assignment. The report also serves as a basis for decision making by the top management where a decision is called for.

As regards the questions of report vis-à-vis different levels of management, the matter should be decided having regard to the circumstances. If management responsible for getting the operational audit being carried out wants only report to be made to it, there does not arise any question of making report to others. In a flexible situation , however the operational auditor may make different reports for different levels of management. Reports made to departmental chiefs should usually contain matters relating to routine procedures. A report to high management should invariably be restricted matters of policies, objectives, control, serious irregularities, lost opportunities or further possibilities . Thus , the objectives of the operational audit would be totally lost in case the report fails to evoke interest of the auditors.

B) The Controller of Insurance , Govt. of India , has recognized the Cost Accountancy qualification as equivalent additional technical qualification for granting license u/s 64 UM of the Insurance Act for appointment as a Surveyor or loss assessor .The scope of work of a Surveyor is to assess loss independently, impartially in the event of claim reported to the underwriters. There are various types of General Insurance policies like Fire, Marine, Fidelity Guarantee, Malicious Damage, Loss of Profit etc.

The Surveyor should thoroughly study the terms and conditions of the policy and understand the types of risks covered, restrictions on claims, conditions to be fulfilled by the policy holder etc.

Loss may arise due to the following reasons:

i) Marine –Loss in transit due to leakage, pilferage etc.

ii) Damage in transit due to accident or improper packaging.

iii)Fire- Loss of stock or plant & machineries.

iv) Strikes, Riots, etc

v) Accident I transit, in factories etc

vi)Malicious damage- willful damage of properties by militant trade unions etc.

vii) Fidelity guarantee – misappropriation of cash/stock by the in-charge

viii) Cash-in transit, cash-in-safe etc.

In all the above cases it is the duty of the Surveyor to assess the quantum of loss strictly as per conditions laid down in the policy. The Insurance Surveyors measure and assess and report on the insured's financial loss. Their report is the basis in which the insurance companies compensate the insured. The ethics of the insurance surveyor's profession are broadly laid down in Subsection 7 of section 64 UM of the Insurance Act. The Surveyor shall not suppress any material fact having a bearing on the claim.

In all the above spheres the Cost Accountant can play an effective role in assessing the actual quantum of loss and assist in settlement of claim.

27 A) You have been appointed as Internal Auditor of FBG Ltd. a Non-Banking Equipment Leasing Finance Company. What are the special points would you keep in mind in the audit of a Non-Banking Equipment Leasing Finance Company?

B) In determining whether to use Computer Assisted Auditing Techniques (CAATs), what are the factors that a management auditor has to consider?

Ans: A)**Special Points in the Audit of Non Banking Equipment Leasing Finance (NBELF) Company:**

(i) Ascertain whether the NBFC has an adequate appraisal system for extending equipment leasing finance.

(ii) Verify whether there is an adequate system in place for ensuring installation of assets and their periodic physical verification. In respect of some major transactions, an auditor should arrange for physical verification of the leased assets so as to dispel any doubts that equipment leasing finance was not extended without the corresponding assets being created.

(iii) Ascertain whether the NBFC has an adequate system for monitoring whether the assets have been adequately insured against and regular maintenance of the leased assets is being carried out by a the lessee.

(iv) Verify the lease agreement entered into with the lessee in respect of the equipment given on lease.

(v) Verify whether the AS 13 in respect of "Accounting for Investments" has been complied with.

B) In determining whether to use CAATs, the auditor should consider the following factors:

(i) *Availability of sufficient IT knowledge and expertise*: It is essential that members of the audit team should possess sufficient knowledge and experience to plan, execute and use the results of CAAT. The audit team should have sufficient knowledge to plan, execute and use the results of the particular CAAT adopted.

(ii) *Availability of CAATs and suitable computer facilities and data in suitable format*: The auditor may plan to use other computer facilities when the use of CAATs on an entity's computer is uneconomical or impractical, for example, because of an incompatibility between the auditor's package programme and entity's computer.

(iii) *Impracticability of manual tests due to lack of evidence*: Some audit procedures may not be possible to perform manually because they rely on complex processing (for example, advanced statistical analysis) or involve, amounts of data that would overwhelm any manual procedure.

(iv) *Impact on effectiveness and efficiency in extracting a data*: It includes selection of samples, applying analytical procedures, time involved in application of CAAT, etc.

(v) Time constraints in certain data, such as transaction details, are often kept for a short time and may not be available in machine-readable form by the time auditor wants them. Thus, the auditor will need to make arrangements for the retention of data required, or may need to alter the timing of the work that requires such data.

28) Write short notes on:

A)OECD

B)CAASB

Ans: A) The **Organisation for Economic Co-operation and Development** (**OECD**) is an international economic organisation of 34 countries founded in 1961 to stimulate economic progress and world trade. It is a forum of countries committed to democracy and the free-market economy, providing a platform to compare policy experiences, seek answers to common problems, identify good practices and co-ordinate domestic and international policies of its members.

The OECD's structure consists of three main elements:

- The OECD member countries, each represented by a delegation led by an ambassador. Together, they form the OECD Council. Member countries act collectively through Council (and its Standing Committees) to provide direction and guidance to the work of Organization.
- The OECD Substantive Committees, one for each work area of the OECD, plus their variety of subsidiary bodies. Committee members are typically subject-matter experts from member and non-member governments. The Committees oversee all the work on each theme (publications, task forces, conferences, and so on). Committee members then relay the conclusions to their capitals.
- The OECD Secretariat, led by the Secretary-General provides support to Standing and Substantive Committees. It is organized in Directorates, which include about 2,500 staff.

The OECD promotes policies designed:

- to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;
- to contribute to sound economic expansion in Member as well as nonmember countries in the process of economic development; and
- to contribute to the expansion of world trade on a multilateral, nondiscriminatory basis in accordance with international obligations.

B) The Council of the Institute of Cost Accountants of India has constituted the Cost Audit and Assurance Standards Board (CAASB) entrusting the responsibility to formulate standards and develop guidance notes in the areas of auditing, assurance, related services and quality control.

Objectives and Functions

The following are the objectives and functions of the Cost Audit and Assurance Standards Board:

- To identify areas in which Standards on Quality Control, Assignment Standards, Standards on Auditing and Standards on Related Services need to be developed.
- To develop Standards on Quality Control, Assignment Standards, Standards on Auditing and Standards on Related Services so that they may be issued under the authority of the Council of the Institute.

- To develop Guidance Notes on issues arising out of any Standard or on auditing issues pertaining to any specific industry or on generic issues so that they may be issued under the authority of the Council of the Institute.
- To formulate and issue Technical Guides, Practice Manuals and other Papers under its own authority for guidance of Cost Accountants in the cases felt appropriate by the Board.
- To review the existing Standards, Guidance Notes, Technical Guides, Practice Manuals and other Papers to assess their relevance in the changed conditions and to undertake their revision, if necessary.
- To provide Interpretations or formulate General Clarifications, where necessary, on issues arising from the Standards.

29 A) What do you understand by 'Audit risks' as per CAAS 101 (Cost Audit and Assurance Standard on Planning an Audit of Cost Statements)?

B) What do you understand by 'assurance engagement' under CAAS 104 (Cost Audit and Assurance Standard on Knowledge of Business, its Processes and the Business Environment)?

Ans: A) Audit risk is the risk that the cost auditor expresses an inappropriate audit opinion on the cost statements that are materially misstated. Audit risk is a function of the risk of material misstatement and detection risk. The risk of material misstatement has two components viz. Inherent Risk and Control risk.

a. Inherent risk – the susceptibility of an assertion about the measurement, assignment or disclosure of cost to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

b. Control risk – the risk that a misstatement that could occur in an assertion about the measurement, assignment or disclosure of cost and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal, operational and management control.

c. Detection risk – the risk that the procedures followed by the cost auditor to reduce audit risk to an acceptable low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

B) An engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. The outcome of the evaluation or measurement of a subject matter is the information that results from applying the criteria. There are two types of assurance engagements a practitioner is permitted to perform: a reasonable assurance engagement and a limited assurance engagement.

Reasonable assurance engagement: The objective of a reasonable assurance engagement is a reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement as the basis for a positive form of expression of the practitioner's conclusion.

Limited assurance engagement: The objective of a limited assurance engagement is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for a negative form of expression of the practitioner's conclusion.

30 A) Explain the Constitution and functions of Audit Committee under Section 292A of the Companies Act, 1956.

B)What do you understand by:

i) Green Room Meetings

ii) Sun Set Clause

iii) Trade Facilitation

Ans: A) Section 292A of the Companies Act, 1956 requires that every public company having not less than Rs. 5 crores of paid up capital shall constitute a committee of Board known as Audit Committee. It shall consist of not less than three directors and such number of other Directors as the Board may determine of which two-third shall be directors other than the Managing Director and whole time director. They shall elect one such member amongst them as Chairman. The auditors, the internal auditor, if any, and the director-in-charge of finance shall attend and participate at meetings of the Audit Committee but shall not have the right to vote.

Every audit committee constituted as above shall act in accordance with the terms of reference specified in writing by a Board. The function of the audit committee as specified in the Companies Act, 1956 are as under:

(i) The audit committee should have discussions with the auditors periodically about the internal control systems, the scope of audit, the audit observations and review the periodical financial statements before submission to the board and also ensure compliance with the internal control systems.

(ii) It shall have the authority to investigate any matter in relation to the items specified in this section or reference to it by the Board and shall have access to the information contained in the records of the company and external professional advice, if necessary.

(iii) Its recommendations on all financial matters including audit report shall be binding on the board.

(iv) The auditors, the internal auditor, if any, and the director-in-charge of finance shall attend and participate at meetings of the Audit Committee but shall not have the right to vote.

(v) To advise and check the compliance of the organisation for policy and regulation aspects.

B i) Green Room Meetings: The "Green Room" is a phrase taken from the informal name of the WTO's director-general's conference room. It is used to refer to meetings of 20-40 delegations, usually at the level of heads of delegations. These meetings can take place elsewhere, such as at Ministerial Conferences, and can be called by the minister chairing the conference as well as the director-general. These meetings help in initiating informal meeting within the WTO(World Trade Organisation).

ii)Sun Set Clause: A sunset clause or provision is part of a law or statute that can repeal the law or parts of it at a specified time period. The history of using sunset clauses is lengthy, dating to the Roman Republic's use of it to pass temporary laws when specific things like tax increases or extra military spending were needed for a short period of time. The phrase *ad tempus concessa post tempus censetur denegata* was added to numerous laws and roughly translates to the statement that a clause was admitted for a short period of time and then denied after that time period had ended. Such clauses are specifically directed at keeping a constant review of restrictive measures like Anti dumping, Counter veiling measures.

iii) Trade Facilitation: **Trade facilitation** looks at how procedures and controls governing the movement of goods across national borders can be improved to reduce associated cost burdens and maximise efficiency while safeguarding legitimate regulatory objectives.

Understanding and use of the term "trade facilitation" varies in the literature and amongst practitioners. "Trade facilitation" is largely used by institutions which seek to improve the regulatory interface between government bodies and traders at national borders. The WTO in an online training package, once defined trade facilitation as: "The simplification and harmonisation of international trade procedures" where trade procedures are the "activities, practices and formalities involved in collecting, presenting, communicating and processing data required for the movement of goods in international trade".