FINAL EXAMINATION

(REVISED SYLLABUS - 2008)

GROUP - IV

Paper-17 : COST AUDIT & OPERATIONAL AUDIT

Section I : Cost Audit

Q. 1. (a) A company has following four operations undergone by a product under cost audit. The input, output and labour costs process-wise are given below :

Process	*Input M.T.*	*Output M.T.*	*Direct Labour cost of the process (Rs.)*
A	**72000**	**64800**	**1,94,400**
B	**75000**	**66000**	**2,64,000**
C	**108000**	**99360**	**4,96,800**
D	**90000**	**83250**	**6,66,000**

Calculate "Direct labour cost per unit of the product under reference" as required in para 8(4) of the Cost Audit Report.

(b) Distinguish between: Efficiency audit and Proprietary audit.

Answer 1. (a)

The total labour cost per tonne of the product under audit must be an aggregation of process-wise labour costs after taking into account the good units occurring in each process.

Process	Input	Output	Factor
A	72000	64800	72000/64800 = 1.1111
B	75000	66000	75000/66000 = 1.1364
C	108000	99360	108000/99360 = 1.0870
D	90000	83250	90000/83250 = 1.0811

Process wise labour costs per M.T of output are :

A 194400/64800 = Rs. 3
B 264000/66000 = Rs. 4
C 496800/99360 = Rs. 5
D 666000/83250 = Rs. 8

Charging all the above to the finished product from process D,

Process A = Rs. 3

Process B = (Rs. 3 × 1.1364) + Rs. 4 = Rs. 7.4092

Process C = (Rs. 7.4092 × 1.0870) + Rs. 5 = Rs. 13.0538

Process D = (Rs. 13.0538 × 1.0811) + Rs. 8 = Rs. 22.1125

Direct Labour cost per M.T. of Finished Product = Rs. 22.11

Answer 1. (b)

Efficiency audit	Proprietary audit
Efficiency audit is directed towards the measurement of whether corporate plans have been effectively executed. It is concerned with the utilisation of resources in economic and most remunerative manner to achieve the objectives of the concern. It comprises of studying the plans of organisation, comparing actual performance with plans and investigating the reasons for variances to take remedial action. For example, the effective utilization of capital in an organization can be gauged by determining return on capital employed.	The term 'propriety' has been defined by Kholer as "that which meets the tests of public interest, commonly accepted customs and standards of conduct and particularly as applied to professional performance, requirements of Government regulations, and professional codes." Thus propriety audit is verification of transactions in best interest of public, commonly accepted customs and standards of conduct. Thus propriety audit seeks to ensure that expenditure is not only appropriate to the circumstances, the objectives for which it was incurred are also achieved . Propriety audit is concerned with executive actions and plans bearing on the finances & expenditure of the company. The cost auditor has to judge : (i) Whether the planned expenditure is designed to give optimum results. (ii) Whether the size and channels of expenditure were designed to produce the best results, and (iii) Whether the return from expenditure on capital as well as current operations could be bettered by some other alternative plan of action.

Q. 2. (a) Define Cost Audit, How it is useful :

(i) To the Management

(ii) To the Society

(iii) To the Shareholders, and

(iv) To the Government?

(b) It is said that 'Cost Audit 'is 'Efficiency Audit'. Explain the statement. What is the evidence from the Cost Audit Report that Cost Audit is 'Efficiency Audit'?

Answer 2. (a)

The Institute of Cost and Works Accountants of India defines cost audit as "a system of audit introduced by the Government of India for the review, examination, and appraisal of the cost accounting records and attendant information, required to be maintained by specified industries." According to CIMA, London, cost audit is "the verification of the correctness of cost accounts and of adherence to the Cost Accounting plan." Thus cost audit comprises of :

(i) the verification of the cost accounting records such as the accuracy of the cost accounts, cost reports, cost statements, cost data, costing techniques and

(ii) examining these records to ensure that they adhere to the cost accounting principle, plans, procedures and objectives.

Usefulness of Cost Audit

Cost audit is useful to the management, society, shareholders and the government as shown below.

(I) Usefulness to the Management :

(i) The management gets reliable data for its day to day operations like price fixing, control, decision making, etc.

(ii) A close and continuous check on all wastages is kept through a proper system of reporting to the management.

(iii) Inefficiencies in the working of the company is brought to the notice of the management to take corrective action.

(iv) Management by exception becomes possible through allocation of responsibilities to individual managers.

(v) The system of budgetary control and standard costing is greatly facilitated.

(vi) A reliable check in the valuation of closing stock and work-in-progress is established.

(vii) It helps in the detection of errors and fraud.

(II) Usefulness to the Society :

(i) Cost audit is often introduced for the purpose of fixation of price. The prices so fixed are based on the correct costing data and so the consumers are saved from exploitation.

(ii) Price increase by the industry is not allowed without proper justification as to increase in cost of production, consumers are saved from unreasonable price hike.

(iii) Cost Audit is also useful for the purpose of Cost Control; Cost reduction and proper utilisation of scarce resources.

(III) Usefulness to Shareholders :

Cost audit ensures that proper records are kept as to purchases and utilisation of material and expenses incurred on wages, overheads, etc. It also ensures that the unit has been run economically and efficiently. It also makes sure that the valuation of closing stocks and work-in-progress is on a fair basis. Thus, the shareholders are assured of a fair return on their investment.

(IV) Usefulness to the Government :

(i) Where the government enters into a cost plus contract, cost audit helps the government to fix the price of the contract.

(ii) Cost audit helps the fixation of selling prices of essential commodities and thus undue profiteering is checked.

(iii) Cost audit enables the government to focus its attention on inefficient units.

(iv) Cost audit enables the government to decide in favour of giving protection to certain industries.

(v) Cost audit facilitates settlement of trade disputes brought to the government.

(vi) Since cost audit ensures efficient running of the business and correct and accurate use of cost data, a healthy competition is generated among the various units in an industry. This imposes an automatic check on inflation.

Answer 2. (b)

'Efficiency Audit' is systematic appraisal of management methods and is intended to assess the actual performance levels relative to applicable benchmarks or standards. The main purpose of Efficiency Audit is to ensure –

(i) that every rupee invested in capital or in other fields give optimum returns, and

(ii) the balancing investment between different functions and aspects designed to give optimum results. 'Cost Audit' may appropriately be called 'Efficiency Audit ' as outlined above.

The following points may be considered in favour of the argument :

(i) Cost Audit Report Rule, Para 4 deals with capacity utilization giving details of licensed capacity, installed capacity, actual production etc. to counter the problem of underutilization of capacity. Thus cost audit can help in improving efficiency by reducing the idle capacity.

(ii) Information revealed by the Cost Audit Report under Para 7 can be highly useful in energy conservation and help firms to improve their efficiency in utilization of energy resources.

(iii) Para 5(b) requires comparison of per unit actual consumption of major inputs with the standard. Such comparison is a very important control ratio and helps in analyzing the production efficiency by bringing to focus the areas where wastage of raw materials occur.

(iv) Efficiency of industrial units is affected by abnormal / non-recurring costs. An analytical study of information given under Para 17 can provide useful information to management to improve its working.

(v) Para 18 reveals information on slow and non-moving stock. This information will guide management in setting up of a sound inventory system and help in improving the inventory ratio.

(vi) Information given under Para 8 helps to analyse the efficiency of the staff employed.

(vii) Para 22 provides information on 'competitive margin against imports'. This helps Govt. not only to promote exports but also to protect Indian aIndustry from unlawful dumping by foreign units.

(viii) Similarly other paras like para 24 on financial position, para 21 on margin per unit of output, para 23 on value addition, para 28 on profit reconciliation, Cost Auditor's observations- will go a long way for cost reduction, increasing productivity, efficiency of the firm etc.

(ix) On basis of the above points, it can be established that cost audit is well designed to bring to light the efficiency aspect of performance of a company and is thus appropriately called 'Efficiency audit'.

Q. 3. (a) Under what conditions will the appointment of Cost Auditor for conducting Cost Audit be appointed in firm's name? Who will authenticate such reports and how? Can proprietary firms also be appointed?

(b) Can a Cost Accountant , who is appointed as the concurrent auditor of a company accept appointed as Cost Auditor of the same company?

(c) Can a Cost Accountant give a certificate of cost for a product manufactured by an SSI Unit owned entirely by his son?

(d) A Cost Accountant takes VRS from his employer and starts practice. He continues his association with his previous as an auditor, on a monthly retainer. Does his actions amount to professional misconduct?

Answer 3. (a)

The Ministry of Corporate Affairs has decided to approve the appointment of cost auditors in firm's name under sub-Section (2) of Section 233-B of Companies Act, 1956 if such proposal is received from Board of Directors of any company subject to the following conditions :

(i) 'All the partners are practicing Cost Accountants within the meaning of Sections 6 and 7 of the Cost Accountants Act, 1959' and

(ii) 'The firm itself has been constituted with the previous approval of the Central Government /Institute as required under Regulation 113 of the Cost and Works Accountants Act, 1959 as amended from time to time.'

When a firm is appointed as Cost Auditors, authentication of Cost Audit Report is to be done by the signature of any one of the partners of the firm in his own hand for and on behalf of the firm. The report should not be signed by merely affixing firm name.

With the amendment to Regulation 10B of the ICWAI Regulations on 25/9/93, a proprietary firm can be approved by the Council of the Institute and therefore can be appointed as Cost Auditor but at the same financial year the Cost Auditor of the Company cannot be its Internal/Concurrent Auditor and may be viewed as a person holding an office of profit.

Answer 3. (b)

A Concurrent Auditor may be viewed as a person holding an office of profit of the company and so can not be appointed as the cost auditor of the same company.

Answer 3. (c)

Strictly speaking, a cost accountant issuing a certificate for a unit in which he has no direct interest , is in order. However, in the given case, the factory is owned by the cost accountant's son, it would be prudent in the part of the Cost Accountant to desist from issuing such a certificate on moral ground.

Answer 3. (d)

The Cost Accountant has severed his connection with his pervious employer as an employee and acts only in an advisory capacity, only after voluntary retirement from his service and starts practice after obtaining practicing license which is legitimate activity of a practicing Cost Accountant, it does not amount to misconduct.

Q. 4. (a) 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	**405000**
Sales (export) 2000 units	**40000**
Material consumed 40 tonnes @Rs. 5 kg.	**200000**
Imported Component @ Rs. 3/unit	**60000**
Direct Labour	**20000**
Factory Overhead	**30000**
Administrative Overhead	**10000**
Freight & Packing (local sales)	**9000**
Packing for export	**4000**
Handling at port	**1000**
Opening Work-in-progress	**20000**
Closing Work-in-progress	**10000**

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. 5000.

(b) As a cost auditor what will you verify on the area of 'overheads and indirect expenditure'?

Answer 4. (a)

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. 5 per Kg)	200000	10.00
Imported components(10000 units @ Rs.3/unit)	60000	3.00
Direct Labour	20000	1.00
Prime Cost	280000	14.00
Factory Overhead	30000	1.50
Opening WIP	20000	1.00
	330000	16.50
Less: Closing WIP	10000	0.50
Works Cost	320000	16.00
Administrative Overhead	10000	0.50
Cost Of Production	330000	16.5

Statement of Cost and Profit on Export Sales

Export Sales : 2000 units	**Total cost (Rs)**	**Per unit cost (Rs)**
Cost of production	33000	16.50
Export packing	4000	2.00
Handling at port	1000	0.5
(A) Cost of Sales	38000	19.00
Export Sales realisation	40000	20.00
Export incentive @ 10% of F.O.B	4000	2.00
Duty Drawback on components	5000	2.50
(B) Total realisation	49000	24.5
Profit on Export (B)-(A)	11000	5.5

Answer 4. (b)

A cost Auditor must verify the following aspects in the area of 'overheads and indirect expenditure'.

(i) that allocation of overheads are as per CAS 3 which deals with overheads;

(ii) that allocation of indirect expenditure over production, sales, and distribution is logical and correct;

(iii) that compared with the value of production in a production shop, the overleaf charges are not excessive;

(iv) that the actual indirect expenditure does not exceed budgets or standard expenditure significantly and that any variations are satisfactorily explained and accounted for;

(v) that the relation of indirect expenditure in keeping with the load on individual production shop is appropriate;

(vi) correctness of appropriate allocation of overhead expenditure (both production and sales) will be certified by Cost Auditor;

(vii) that allocation of overheads between finished products and unfinished products is in accordance with principles as per CAS 3.

Q. 5. (a) The following is the abridged Balance Sheet of XYZ Ltd. for the year ended 31st March 2011.

The profit after interest provision of Rs.1300 lacs for the same period was Rs.3530 lacs. Compute the following figures/ratios as stipulated in para 3 of Annexure to Cost Audit Report(for the company as a whole) :

Liabilities	*Rs. (In lacs)*	*Total Rs. (In lacs)*	*Assets*	*Rs. (In lacs)*	*Total Rs. (In lacs)*
Share Capital		**5,600**	**Gross Block**	**57,800**	
Reserves & Surplus :			***Less*: Depreciation**	**15,600**	**42,200**
General Reserve	**12,500**		**Capital WIP**		**1,500**
Share Premium	**18,100**		**Investments**		**4,400**
Revaluation Reserve	**6,800**	**37,400**	**Current Assets,**		
			Loans & Advances :		
Secured Loan :			**Inventories**	**13,200**	
Term loan	**17,200**		**Sundry Debtors**	**6,400**	
Cash Credit	**6,000**	**23,200**	**Cash & Bank Balances**	**1,240**	
Current Liabilities & Provisions		**19,000**	**Advances to suppliers of Equipment**	**2,400**	
			Other Advances	**8,800**	**32,040**
			Miscellaneous Expenses carried forward		**5060**
		85,200			**85,200**

(i) Capital employed

(ii) Net worth

(iii) Net worth as a percentage of long term borrowings and liabilities.

(iv) Profit as a percentage of capital employed.

(b) Distinguish between "Notes" and "Qualifications" in the Cost Audit Report. Give examples.

Answer 5. (a)

(i)

		Rs. in lacs
Capital Employed : Net Block		42,200
Less : Revaluation Reserve		6,800
Add : Current Assets	32,040	
Less : Advances to suppliers for equipment	2,400	29,640
Less : Current Liabilities		19,000
Total capital employed		46,040

(ii)

	Rs. in lacs
Networth : Share capital	5,600
Add : General Reserve	12,500
Add : Share Premium	18,100
Total	36,200
Less : Misc. Exp. c/f	5,060
	31,140

(iii) Net worth as a percentage of long term borrowings :

	Rs. in lacs
(i) Net worth	31,140
(ii) Long term borrowing	17,200
(i) as a % age of (ii) (31,140/17,200 × 100)	181.05%

(iv) Profit as a percentage of capital employed.

	Rs. in lacs
Profit after interest	3,530
Interest	1,300
Profit before interest	4,830
Profit as a % age of capital employed = 4,830/46,040 × 100	10.49%

Answer 5. (b)

Section 227(2) of the Company's Act, 1956, requires the auditor to make report to the shareholders on the accounts examined by him. When in any of the matters as required to be stated, the Auditor feels that satisfactory compliance was not done by the company, the auditor shall state the fact of none-compliances and suitably qualify the point with reason.

The same principle also holds good for the Cost Auditor, though the report is to be submitted to the Central Government. Wherever a particular statement or basis of costing needs some explanation or clarification, the auditor shall add suitable “Notes” at appropriate places by way of explanation. For example, if a company has added a new activity, on account of which a portion of overhead charges to a product gets reduced during a year, this may be explained by way of “Notes”.

On other hand if a company has deviated from the accepted Cost Accounting principles, in order to inflate costs, the auditor shall make a qualified report to the Government.

For example, if a company has spent a huge amount on evaluation of new product ideas and has charged the entire amount to the Administrative Overhead, the Cost Auditor should qualify the excess amount and the impact on each unit of Cost of Production of the products under audit. Such report will be a “qualified report”.

Q. 6. (a) Manufacture’s specification capacity for a machine per hour = 750units
No. of shifts (each shift of 8 hours each) = 3 shifts

Paid holidays in a year (365 days) :

Sundays 52 days

Other holidays 8

Annual maintenance is done during the 8 other holidays. Preventive weekly maintenance is carried on during Sundays.

Normal idle capacity due to lunch time, shift change etc = 1 hour.

Production based on sales expectancy in past during last five years = 38.10, 44, 32.91, 39.25, and 38.30 lac units.

Actual production during the year = 38.20 units.

Calculate Installed capacity, Available capacity, Actual capacity, Idle capacity and Abnormal idle capacity as per CAS 2 from the data given.

(b) What as a Cost Auditor, will you verify in the area of work-in-progress?

Answer 6. (a)

Installed capacity for the machine = 365 × 8 × 3 × 750
= 65.70 lac units

Available capacity = (365-52-8) × (8-1) × 3 × 750
= 305 × 7 × 3 × 750
= 48.04 lac units

Normal capacity = (38.10 + 39.25 + 38.30)/3
= 38.55 lac units.

Actual capacity utilization = 38.20 lac units
= 38.20/65.70 × 100
= 58.14%

Idle capacity = 65.70 – 38.20
= 27.50lac units
= 27.50 /65.70 × 100
= 41.86%

Abnormal idle capacity = 38.55 – 38.20
= 0.35 lac units

Answer 6. (b)

The Cost Auditor should verify the following area of work-in-progress :

(i) That the work-in-progress has been physically verified and it agrees with the quantity shown in job-cards of uncompleted work.

(ii) That the valuation of the work-in-progress is correct with reference to the stage of completion of each job or process and the value job cost cards or process cost sheet.

(iii) That there is no over-valuation or under valuation of opening work-in-progress or closing work-in-progress, thereby artificially, pushing up and down net profits or net assets as the case may be.

(iv) That the volume and value of work-in-progress is not disproportionate as compared with finished production.

Q. 7. (a) How will you treat the following items in the Cost Accounting Records?

(i) CENVAT availed as credit on purchased raw materials.

(ii) Voluntary Retirement Compensation paid to workers included under 'wages'.

(iii) Profit on sale of fertilizers to cane growers by a sugar company.

(iv) Commission paid to the Managing Director as a percentage of profit.

(v) Interest received on security deposit with the Electricity Board.

(b) 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?

Answer 7. (a)

(i) CENVAT credit is to be deducted from the cost of raw materials, and only the net value should be taken in the priced stores ledger, which forms the basis for pricing material issues to cost centres.

(ii) Voluntary retirement is a one time non-recurring expenditure. Even if it is included under salaries and wages in Financial Accounts, it should be excluded for Cost Accounts purposes. This is a item of reconciliation between Cost and Financial Accounts.

(iii) This is purely a trading activity. Hence profit derived from such activity should be shown as a item of reconciliation between Financial and Cost Accounts.

(iv) This is clearly an item to be excluded from cost. This should be shown as an item in the reconciliation statement in Para 28 between Costing and Financial Profit and Loss Account.

(v) Interest on security deposit with the Electricity Board can be set-off against interest paid or alternatively, it can be taken as a credit against overheads.

Answer 7. (b)

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.

Q. 8. (a) (I) Who can authenticate the Compliance Report as per the Companies (Cost Accounting Records) Rules 2011?

(II) Whether the Compliance Report is to be prepared for the 'company as a whole'.

(b) What is meant by turnover under Companies (Cost Accounting Records) Rules? Is gross turnover inclusive of excise duty?

Answer 8. (a)

(I) As per Rule 5, the Compliance Report and annexure thereto is required to be certified by a "cost accountant" as defined under Rule 2(c).

As per Rule 7, the annexure to the Compliance Report is to be duly approved by the Board of Directors.

A "cost accountant" within the definition of these Rules does not include :

(i) A member holding a part-time certificate of practice; or

(ii) A member who is in full time employment whose membership fees are in arrears;

(iii) A member of ICWAI who has been admitted as a member through reciprocal arrangement of membership by virtue of being a member of Institute of Management Accountants USA.

(II) Yes, the Compliance Report is to be prepared for the 'company as a whole' under different product groups.

Answer 8. (b)

As per Rule 2(p), "Turnover" means gross turnover made by the company from the sale or supply of all products or services during the financial year. It includes any turnover from job work or loan license operations but does not include any nonoperational income.

From a reading of the Rules, it appears that the word "Gross" denotes "total". Hence, the "Turnover" under these Rules would exclude duties and taxes.

Q. 9. (a) What are 'waste multipliers' in textile costing? The following are the process wise wastages on inputs in the year 2010-11.

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.

(b) Do companies engaged in the eight (8) products/activities, which are excluded from the purview under Rule 3(a) to 3(h) of Companies (Cost Accounting Records) Rules 2011, be required to file Compliance Report?

Answer 9. (a)

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 = $\frac{1}{75.98} = 0.013161$.

Answer 9. (b)

Companies engaged in activities or products to which the cost accounting records rules listed under Rule 3(a) to 3(h) apply will not be required to file a Compliance Report until these Rules are amended.

However, if the concerned company is also engaged in other activities covered under the Companies (Cost Accounting Records) Rules 2011, in that case the company would be required to file a Compliance Report.

Q. 10. (a) Why is Cost Audit Report not made public? State whether a member of Parliament have access to the Cost Audit Report?

(b) State with reasons whether a person can be appointed as Cost Auditor under following circumstances :

(i) A person has been appointed as cost auditor for twenty products manufactured in seven companies. He is again proposed for appointment as Cost Auditor for three more products, manufactured by two other companies.

(ii) A person practicing as C.A is also a qualified Cost Accountant. He is being recommended for appointment as Cost Auditor.

(iii) A Cost Accountant is working as 'Director Finance' of a Cooperative Sugar Mill. He has rich experience of the Industry. With permission of his employer, he obtains Certificate of Practice. A sugar manufacturing company in private sector desires to propose his name as cost auditor in order to utilize his rich experience.

Answer 10. (a)

According to Cost Audit Report Rules, the Cost auditor is required to submit the Cost Audit Report to the Central Government and a copy thereof to the company concerned. The shareholders and the general public have no access to the Cost audit Report unlike the Financial Audit Report. Cost Audit Report is treated as a confidential document as it contains vital information which if divulged would affect competitiveness of trade and business of the company whose information is so divulged. A Cost Audit Report contains important information such as :

(i) A detailed note on manufacturing process of the Company.

(ii) Quantities and rates of various items of input materials, i.e the entire recipe is given.

(iii) Quantities and rates of utilities consumed.

(iv) Average sales realization, sales promotion expenses including discount allowed.

(v) Details regarding export market, quantity exported, F.O.B realization etc.

(vi) Any other energy saving measure or technical improvement in process , which a company might have implemented arising out of its own research.

Such data, as a measure of business strategy should not be made available to the competitors who may take advantages and put the company to a disadvantageous position. As such cost data is a secret matter and the company secrets and management strategy contained therein should not be disclosed. There is a provision under subsection(10) of section 233-B of the Companies Act that Central Government can direct a company to make available the Cost Audit Report in full or in part to the shareholders. However this power has not been exercised so far.

It is for the same reason mentioned above that members of parliament are not allowed to access Cost Audit Report. It is the Parliament who has made the law under which Cost Audit Report is treated as confidential document other than for the Government and the company. So unless the law is changed, members, who are representatives of public cannot have access to Cost Audit Report. But Government have agreed to give all non confidential information like overall profitability, capacity utilization etc from Cost Audit Report. In view of what has been stated above, there is no specific provision in the Companies Act or Cost Audit Report Rules to make the Cost Audit Report being made available to members of Parliament.

Answer 10. (b)

The person can be appointed as he has been Cost Auditor of only seven companies. A person can be appointed as Cost Auditor of twenty companies at a time of which not more than ten companies can have paid up capital of Rs. Twentyfive lacs or more. In this case total number of companies for which his name has been proposed is nine only. Number of products is of no relevance at all.

(i) A practicing C.A cannot be appointed as Cost Auditor as a person cannot hold Certificate of Practice in two Institutes. To be appointed as Cost Auditor a person needs to hold Certificate of Practice from The ICWAI and not merely qualification in Cost Accountancy.

(ii) Even though the person is holding Certificate of Practice, still he cannot be appointed as Cost Auditor as under Section 224 of Companies Act read with Section 233(B), a person in 'whole time employment' cannot be appointed as Cost Auditor.

Q. 11. Answer the following questions with reference to CAS 13.

(a) How do you define a service cost centre?

(b) How is cost computed if service is provided in-house?

(c) How is cost computed if service is provided by contractors?

(d) How will cost of production and distribution of service be determined?

Answer 11. (a)

The cost centre which primarily provides auxiliary services across the enterprise. The cost centre which provides services to Production, Operation or other Service Cost Centre but not directly engaged in manufacturing process or operation is a service cost centre. A service cost centre renders services to other cost centres / other units and in some cases to outside parties.

Examples of service cost centres are engineering, workshop, research & development, quality control, quality assurance, designing, laboratory, etc.

However the definition excludes Utilities and Repairs & Maintenance Services dealt with in CAS-8 and CAS-12 respectively.

Answer 11. (b)

Cost of in-house services shall include cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources used in such service. Cost of other resources includes related overheads.

Answer 11. (c)

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.

Answer 11. (d)

The cost of production and distribution of the service shall be determined based on the normal capacity or actual capacity utilization whichever is higher and unabsorbed cost, if any, shall be treated as abnormal cost.

Q. 12. How would you treat the following as per CAS 11 related to Administrative Overheads?

(a) Leased Assets

(b) Administrative services procured from outside

(c) Cost of software.

Answer 12. (a)

In case of leased assets, if the lease is an operating lease, the entire rentals shall be included in the administrative overheads. If the lease is a financial lease, the finance cost portion shall be segregated and treated as part of finance costs.

Answer 12. (b)

Cost of administrative services procured from outside 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.

Answer 12. (c)

Cost of software (developed in house, purchased, licensed, or customized), including upgradation cost shall be amortized over its estimated useful life.

Q. 13. (a) What do you mean by captive consumption according to CAS 4?

(b) How would you treat cost of forex component of imported packing material according to CAS 9?

(c) How would you treat overtime premium as per CAS 7 related to Employee Cost?

(d) How should inward transportation and outward transportation charged as per CAS 5?

Answer 13. (a)

Captive Consumption means the consumption of goods manufactured by one division or unit and consumed by another division or unit of the same organization or related undertaking for manufacturing another product(s).

Answer 13. (a)

The forex component of imported packing material cost shall be converted at the rate on the date of the transaction. Any subsequent change in the exchange rate till payment or otherwise shall not form part of the packing material cost.

Answer 13. (c)

Overtime premium shall be assigned directly to the cost object or treated as overheads depending on the economic feasibility and specific circumstances requiring such overtime.

Answer 13. (d)

The inward transportation cost shall form part of the cost of procurement of materials which are to be identified for proper allocation/apportionment to the materials /products. However outward transportation costs shall form part of the cost of sale and allocated/apportioned to final products on a suitable basis.

Q. 14. (a) Define direct expenses as per CAS 10. How are they identified?

(b) (i) How should cost of repairs and maintenance carried out by outside contractors be computed as per CAS 12?

(ii) How would you treat cost of spares as per CAS 12?

(c) How would you compute cost of self generated utilities for (i)own consumption (ii)inter company transfers as per CAS 8?

Answer 14. (a)

Direct expenses are expenses relating to manufacture of a product or rendering a service, which can be identified or linked with the cost object other than direct material cost and direct employee cost4. Examples of Direct Expenses are royalties charged on production, job charges, hire charges for use of specific equipment for a specific job, cost of special designs or drawings for a job, software services specifically required for a job, travelling expenses for a specific job.

Identification of Direct Expenses shall be based on traceability in an economically feasible manner. If an item of Direct Expenses does not meet the test of materiality, it can be treated as part of overheads.

Answer 14. (b)

(i) Cost of repairs and maintenance carried out by outside contractors shall include charges made by the contractor and cost of own materials, consumable stores, spares, manpower, equipment usage, utilities and other costs used in such jobs.

(ii) Cost of spares which do not enhance the future economic benefits from the existing asset beyond its previously assessed standard of performance shall be included under repairs and maintenance cost.

High value spare, when replaced by a new spare and is reconditioned, which is expected to result in future economic benefits, the same shall be taken into stock . Such a spare shall be valued at an amount that measures its service potential in relation to a new spare which amount shall not exceed the cost of reconditioning the spare . The difference between the total of the cost of the new spare and the reconditioning cost and the value of the reconditioned spare should be treated as repairs and maintenance cost.

Example : The cost of new spare is Rs. 80 lacs and the value of existing spare after reconditioning is estimated at Rs. 20 lacs, the difference of Rs. 60 lacs should be treated as repairs and maintenance costs.

Answer 14. (c)

(i) Cost of self generated utilities for own consumption shall comprise direct material cost, direct employee cost, direct expenses and factory overheads.

(ii) Cost of Utilities generated for the inter company transfers shall comprise direct material cost, direct employee cost, direct expenses, factory overheads, distribution cost and share of administrative overheads.

Q. 15. Answer the following with respect to Companies(Cost Audit Report Rules) 2011.

(a) A steel tube manufacturing company is having turnover of Rs. 85 crores from all its activities. The company has filed its prospectus with SEBI for a public issue of equity shares and it hopes to complete the public offering by October 2011 end. Whether cost audit will become applicable to the company even when its turnover is less than Rs. 100 crore? If yes, then from which financial year will cost audit become applicable?

(b) What are the duties of the Company under the Cost Audit Report Rules, 2011?

Answer 15. (a)

In the given case, the company's equity is in the process of listing on a stock exchange in India. Hence, it meets the requirement of Rule 3(1) of the Companies (Cost Accounting Records) Rules 2011. Consequently, the said Rules are applicable to the company in place of erstwhile Cost Accounting Records (Steel Pipes & Tubes) Rules 1984. The cost audit order No. 52/26/CAB-2010 dated 3rd May 2011 has brought under the ambit of cost audit every company engaged in 6 specific industries, which includes Steel Tubes & Pipes. Though the turnover criteria of Rs. 100 crores is not met by the company, the company's equity is in the process of listing on a stock exchange in India. Hence, cost audit will be applicable to the company under the order dated 3rd May 2011 on and from the financial year 2011-12.

Answer 15. (b)

Every company as specified in sub-rule (1) shall, within ninety days of the commencement of every financial year, file an application with the Central Government seeking prior approval for appointment of the cost auditor, through electronic mode, in the prescribed form, along with the prescribed fee as per the Companies (Fees on Applications) Rules, 1999, and requisite enclosures. However, where a company is covered under cost audit for the first time vide cost audit order dated 30th June 2011, the period of 90 days shall be counted from the date of this order. Every company shall follow the procedure prescribed vide Ministry of Corporate Affairs' General Circular No. 15/2011 [File No. 52/5/CAB-2011] dated April 11, 2011. The company and every officer thereof, including the persons referred to in sub-section (6) of section 209 of the Companies Act, 1956 shall make available to the cost auditor, such cost accounting records, cost statements, other books and documents, and Annexure to the Report, duly completed, as would be required for conducting the cost audit, and shall render necessary assistance to the cost auditor so as to enable him to complete the cost audit and submit his report within the time limit specified in rule 5, i.e., within 180 days from the close of the Company's financial year to which the report relates. The Annexure prescribed with the cost audit report shall be approved by the Board of Directors before submitting the same to the Central Government by the cost auditor.

Section II : Operational Audit

Q. 16. (a) Internal Audit is an independent appraisal activity within an organisation for review of operations as a service to management. Discuss.

(b) Write short explanatory note on - Flow chart technique for evaluation of internal control.

Answer 16. (a)

Traditionally, the expression, 'internal audit' refers to an audit conducted on behalf of the management to ensure that the existing internal controls are adequate and effective; the financial accounting and other records and reports show results of actual operations accurately and promptly; and each unit of the organization follows the policies and procedures as laid down by the top management. Thus, during initial stages, the internal auditor's significant emphasis was on detection of errors and frauds focussed on financial aspects of the enterprise.

Over a period of time, the participation in non-financial areas increased rapidly since the business scene was changing very fast. Pressure on the managements was building up due to enormous growth of organisations in size and operations. The complexity of busines activities and voluminous transactions led to increasing dependence on large number of people. It was in this context that the management recognised the possibility of utilising the services of internal audit department in a much more effective manner. And this was possible with only a little extra expenditure. It was strongly felt that the expertise built by the internal auditor in financial operations should be equally useful for non-financial operation of the enterprise as well. This is how in the expression given in the question all three words viz. "accounting", "financial" and "other operations" stand on equal importance. The Statement of Responsibilities of Internal Auditor issued in 1971 by the Institute of Internal Auditors, USA cut the umbilical cord to the books of account and simply defined internal auditing as, Internal auditing is, "the review of operations as a service to management". With this revision of definition, it was made clear that accounting activity is also one of the operational areas of the entity like production, research and development, personnel, marketing, etc. In 1981, the definition was modified as under :

"Internal auditing is an independent appraisal function established within the organization to examine and evaluate its activities as a service to the organisation. It is a managerial control which functions by measuring and evaluating the effectiveness of other controls."

With this, internal auditing came to be recognised as a management resource- an important part of the total internal control system for which management is primary responsible. Today, the total range of services rendered by the internal auditor covers both protective needs and constructive needs stressing on performance and operations. Specifically, the range of activities as outlined in the Statement of Responsibilities of Internal Auditors is as follows :

(i) Reviewing and appraising the soundness, adequacy and application of accounting, financial, and other operating controls, and promoting effective control at reasonable cost.

(ii) Ascertaining the extent of compliance with established policies, plans and procedures.

(iii) Ascertaining the extent to which company's assets are accounted for and safeguarded from losses of all kinds.

(iv) Ascertaining the reliability of management data developed within the organisation.

(v) Appraising the quality of performance in carrying out assigned responsibilities.

(vi) Recommending operating improvements.

A close examination of those services help us in identification of primary protective services viz second, third and fourth, and those that are primarily directed to further improvement in operations (i.e. the first, fifth, and sixth).

The modern concept of internal auditing suggests that internal auditing need not be confined to financial transactions and that its scope may be extended to the task of reviewing whether the resource utilisation of the enterprise is efficient and economic. This would necessitate a review of all operations of the enterprise as also an evaluation of the effectiveness of management. In this sense, the internal auditor performs what is known as 'Operational audit' or 'Management audit'. Thus, the expression makes it clear that the scope of activities of internal auditor is not restricted to financial areas but extends to non-financial areas as well.

The Institute of Internal Auditors itself has revised the definition of Internal Auditing. The revised definition is :

"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process."

Answer 16. (b)

A flow-chart is a graphic presentation of the flow of transactions and documents in an organisation. Evaluation of the internal controls forms an important part of the auditing process as it enables the auditor to know the weaknesses and strengths of the accounting system and consequently the general reliability of the accounting records and data emanating there from. Also, it helps the auditor to decide upon the relative audit thrust needed in the different accounting areas. A properly drawn up flow chart can provide a neat visual picture of the whole activities of the section or department involving flow of documents and activities. More specifically it can show :

(i) at what point a document is raised internally or received from external sources;
(ii) the number of copies in which a document is raised or received;
(iii) the intermediate stages set sequentially through which the document and the activity pass;
(iv) distribution of the documents to various sections, departments or operations;
(v) checking authorisation and matching at relevant stages;
(vi) filing of the documents; and
(vii) final disposal status.

Different methods are available with the auditor to evaluate the internal controls but the flow-charting method is, perhaps, the most scientific and advantageous as compared to other methods. It provides the most concise but comprehensive way of recording the operating controls along with the flow of transactions and documents. In the flow-chart, a total and complete visual picture and control system is available and as such its reception in the human mind is direct. In drawing a flow-chart, organised and concentrated application of mind is essential to reflect the control system in a rational manner. Even in a large and complex organisation, the control system could be depicted by few sheets of neatly drawn flow-charts. However, in drawing the flow chart, the auditor has to take few precautions, e.g., flow-charts should not be lengthy and cumbersome, should be neat, should portray the flow completely with final disposal of papers and there should be proper use of symbols and lines. The auditor will be able to visually correlate the functions and the related controls and assess the adequacy and effectiveness thereof much quickly than a possibly in any other method.

Q. 17. (a) "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) "Operational auditing is not different from internal auditing." Discuss.

Answer 17. (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 be best 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 of 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 management.

Answer 17. (b)

Internal auditing is an activity carried out by the internal staff of the organisation to meet the management requirements of information. The definition of internal auditing as given by the Institute of Internal Auditors of New York, in fact, is so wide in its scope that it covers both operational and management auditing. According to the Institute of Internal Auditors, "the overall objective of internal auditing is to assist all members of management in the objective discharge of their responsibilities, by furnishing them with objective analysis, appraisals, recommendations and pertinent comments concerning the activities reviewed. The internal auditor, therefore, should be concerned with any phase of business activity wherein he can be of service to organisation". According to the definition, the overall objective of internal auditing is to assist all members of management in the objective discharge of their responsibilities, by furnishing them with objective analysis, appraisals, recommendations and relevant comments concerning the activities reviewed. The internal auditor, therefore, should be concerned with any phase of business activity wherein he can be of service to the organisation. Naturally, when an auditor is concerned with the appraisal of operations, he would be performing the role of an operational auditor. Another important point that this definition throws up is that operational auditing is essentially a function of internal auditing staff. Traditionally, the internal auditing was concerned with the financial transactions only. It was during early 1940's, the concept of operational auditing came into existence. According to Cadmus "operational auditing is not different from internal auditing, it is merely an extension of internal auditing into operational areas. It is characterised in both financial and operational areas – by the auditor's approach and state of mind". The main objective of operational auditing is to verify the fulfillment of plans and sound business requirements as also to focus on objectives and their achievement as against the performance yardsticks evident from in the management objectives, goals and plans, budgets records of past performance, policies and procedures. Industry standards can be obtained from the statistics provided by industry, associations and government sources. It should be appreciated that the standards may be relative depending upon the situation and circumstances; the operational auditor may have to apply them with suitable adjustments. It might appear from the above that an internal auditor is not concerned with operational aspects and operational auditor is, not concerned with financial aspects which is not so. Because traditionally, internal auditors had been engaged in a sort of protective function, deriving their authority from the management. They examined internal controls in the financial and accounting areas to ensure that possibilities of loss, wastage and fraud are not there; they checked the accounting books and records to see, whether the internal checks are properly working and the resulting accounting data are reliable. They also looked into the aspect of safety of the assets and properties of the company. Some element of operational auditing could be found even in these traditional functions of internal auditors, specially in the context of fraud, wastage and loss. Internal auditors emboldened by their ability to appraise financial and accounting control gradually started extending their field to cover non-accounting control as well. On the other hand, it should not be assumed, that, since an operational auditor is concerned with the audit of operations and review of operating conditions, he is not concerned with the financial aspects of transaction and controls. A point has already been made that the special expertise acquired by the operational auditor, that enables him to view the controls and operations from the management point of view, can be carried back to his review of the financial areas. In the matter of cash transactions, the operational auditor will look into such aspects as the quantum of cash in hand (by relating it to the requirement of cash to be held) carried generally or the use of cash not immediately required. Also he will review the operational control on cash to determine whether maximum possible protection has been given to cash. Similarly, in the audit of stocks, he would have management policy. In pure administrative areas on stock, he will see whether adequate security and insurance arrangements exist for protection of stocks.

Thus, over a period of time, the scope of internal auditing was widened to cover not only accounting and financial operations but other operations such as marketing, personnel, production, etc. As per the modern definition of internal auditing, there is no difference between the two. However, still some auditors believe that there might exist difference between the two on account of perception as far as scope of the two is concerned which in fact is not true as evident from the foregoing analysis.

Q. 18. (a) State in brief the behavioural aspects encountered in the management audit. Suggest the ways to solve them.

(b) What are the Management Audit Questionnaires?

Answer 18. (a)

Behavioural aspects encountered in Management Audit :

Financial auditors deal mainly with figures. Management auditors deal mainly with people. There are many causes for behavioural problems arising in the review function of management audit. Particularly, when management auditors performs comprehensive audit of operations, they cannot be as well informed about such operations as a financial auditor in a financial department. Operating processes may be unfamiliar and complex. The operating people may be speaking a language and using terms that are foreign to the auditor's experience. The nature and causes of behavioural problems that the management auditor is likely to face in the discharge of the review function that is expected of him and possible solutions to overcome these problems are discussed below :

(1) **Staff / Line conflict :** Management auditors are staff people while the members of other departments are line people. Management auditors tend to discount the difficulties the line staff may face, if called on to act on the ideas of management auditors. Management auditors are specialists in their field and they may think their approach and solutions are the only answers.

(2) **Control :** The management auditor is expected to evaluate the effectiveness of controls, there is an instinctive reaction from the auditee that the report of the auditor may affect them. There is a fear that the action taken based on the management audit report will affect the line people. It breeds antagonism. The causes are as under :

   (i) Fear of criticism stemming from adverse audit findings.

   (ii) Fear of change in day to day working habits because of changes resulting from audit recommendations.

   (iii) Punitive action by superior prompted by reported deficiencies.

   (iv) Insensitive audit practices.

   (v) Hostile audit style.

   Solution to behavioural problems: The following steps may be taken to overcome the aforesaid problems :

   (i) To demonstrate that audit is part of an overall programme of review for protective and constructive benefit.

   (ii) To demonstrate the objective of review is to provide maximum service in all feasible managerial dimensions.

   (iii) To demonstrate the review will be with minimum interference with regular operation.

   (iv) The responsible officers will be involved in the process of review of the findings and recommendations before the audit report is formally released.

It is essential to create an atmosphere of trust and friendliness so that audit reports will be understood in their proper perspective.

Finally, it needs hardly any emphasis that there should be right management culture, enlightened auditees and auditors of the right calibre. May be to expect a combination at all times of all the three is asking for the impossible. But, a concerted effort by the management, auditors and auditees to achieve a more acceptable climate would go a long way to achieve the goal.

Answer 18. (b)

A management audit questionnaire is an important tool for conducting the management audit. It is through these questionnaires that the auditors make an inquiry into important facts by measuring current performance. Such questionnaires aim at a comprehensive and constructive examination of an organisation's management and its assigned tasks. Overall it is concerned with the appraisal of management actions in accomplishing the organisation's objectives. Its primary objective is to highlight weaknesses and deficiencies of the organisation. It includes a review of how well or badly the management functions of planning, organising, directing and controlling are being performed. In addition it evaluates how effective the decision-making process is accomplishing the stated organisation objectives. Within this framework, the questionnaire provides a means for evaluating an organisation's ongoing operations by examining its major functional areas. There are three possible answers to the management audit questions : "Yes", "No" and "N.A.", (not applicable). A "Yes" answer indicates that the specific area, function, or aspect under study is functioning in an acceptable manner; no written explanation is needed in that case. On the other hand, a "no" answer indicates unacceptable performance and should be explained in writing. Questionnaire comments on negative answers not only provide documentation for future reference, but, more important, provide background information for undertaking remedial action. Those questions that are not applicable and should be ignored in the audit are checked in the "N.A." column. The management audit questionnaire does not give answers, but simply asks questions. If all questions are answered with a 'yes', operations are proceeding as desired. On the other hand, if there are one or more 'no' answers, difficulties are being experienced and must be explained in writing. If the question does not apply, the N.A. (not applicable) column is checked. Thus, management audit questionnaire for this part of the audit not only serves as a management tool to analyse the current situation; more importantly, it enables the management auditors to synthesise those elements that are causing organisational difficulties and deficiencies.

Q. 19. (a) What is the purpose of the audit prescribed inder Sec. 14AA of the Central Excise Act?

(b) What are the possible areas for misuse/malpractice?

(c) Prepare a checklist for carrying out audit under Sec. 14AA of the Central Excise Act.

Answer 19. (a)

The purpose of audit under section 14AA of Central Excise Act is to find out the reasons of fraud when the Commissioner of Central Excise has reason to believe that the credit of duty availed of or utilized under the rules by a manufacturer is not within normal limits.

Answer 19. (b)

Possible areas of misuse/malpractice are as follows :

(i) Showing consumption of inputs higher than the norms and corresponding higher wastage/scrap.

(ii) Claiming CENVAT on inputs used for production of goods exempted from duty.

(iii) Claiming CENVAT on capital goods which are specially excluded.

Answer 19. (c)

Check list for carrying our an audit under section 14AA of Central Excise Act are as follows :

(i) Name of the industry and method of costing adopted.

(ii) Principal raw materials used, the input/output ratio norms established for the industry/company.

(iii) Percentage of wastage/scrap/loss- standard and actual for actual for the previous five years.

(iv) Value of inputs for which CENVAT has been availed /utilized vis-à-vis the value of inputs actually consumed in production.

(v) In case of consumables for which CENVAT has been availed , whether expenses charged to revenue are gross or net of CENVAT.

(vi) Procedures adopted for payment of duty on goods sent to subcontractors/other factories of the assessee.

Q. 20. You are appointed by a bank to study the feasibility of taking over a small scale unit which is sick by a large scale undertaking which is principal customer for the small scale unit. List the points you would consider for preparing your report.

Answer 20.

Industries tend to become sick mainly due to the following reasons :

(i) Improper management of working capital affecting liquidity.

(ii) Dependence on single or limited sources of raw material.

(iii) Dependence on limited number of customers.

(iv) Lack of proper supervision due to inefficiency of management.

(v) Lack of demand for the product due to change of market conditions.

When a large scale undertaking wishes to take over a small scale unit, it should first question itself as to whether it was instrumental in making the SSI unit sick by delaying payment. Infact this is a very valid reason for many units to become sick which are ancillary to large undertakings. Apart from that the following points needs to be considered while considering a takeover :

(i) **Legal possibility –** It should be verified whether the product is exclusively reserved for SSI or a large scale undertaking can enter into its manufacture as a separate division. Whether there is any legal hindrances from the view point of Income Tax Act, Companies Act, Competition Act etc.

(ii) **Reasons for sickness –** A study of the accounts of the unit for last five years and Directors' Report will throw light on the reasons of sickness.

(iii) **SWOT analysis of the buyer –** A study of strengths, weakness, opportunities and threats faced by the buyer, its core competencies, whether the proposal is in line with long term goals and objectives of the undertaking needs to be considered while studying the viability of takeover. A detailed evaluation will involve appraisal in the following areas :

(A) Technical feasibility :

(a) The size of unit as compared to other units in the industry, the level of technology and speed of its change, and total number of existing units making the same product range.

(b) Area of land and scope of further expansion. Whether the property is freehold or under lease agreement.

(c) Condition of plant and machinery-Their age and level of technology and scope of expansion and diversification.

(d) Utilities — availability of power and water.

(e) Raw material sources and cost-Are there any fiscal disadvantages under Central Excise and Sales Tax Laws?

(f) Effluents treatment – Whether the sickness was due to inability to put up proper pollution control plant which is too costly?

(g) Transport facilities available-Whether the area is well connected via rail/roads/sea?

(B) Managerial Feasibility :

(a) Whether partners / directors of SSI unit are willing sell the majority stake?

(b) Whether existing key executives will continue even after takeover?

(c) Is present labour force excessive and is it possible to reduce the strength by introduction of VRS?Are there any restrictive Union agreements?

(C) Marketing Feasibility :

(a) Are there any quality complaints?

(b) What is the possibility of product obsolescence?

(D) Legal feasibility :

Are there any major legal proceedings pending against the unit –either for liabilities or noncompliance of statutory obligations?

(E) Financial feasibility :

(a) Comparison of networth of business as per book value of assets, replacement costs of assets, market value of shares, and other determinants of price based on earning potential.

(b) Availability of concessional loan due to location of the unit in backward areas.

Q. 21. Explain whether the following amounts to professional misconduct by a Cost Accountant :

(a) Mr. Y, a practicing Cost Accountant, takes up job as a full time lecturer in a college affiliated to Delhi University.

(b) M/s FBH, a firm of Cost Accountants in practice, develops a website "fbh.com". The colour chosen for the website was a very bright yellow and the web-site was to run on a "push" technology where the names of the partners of the firm and the major clients were to be displayed on the web-site.

(c) X, a Cost Accountant has sent letters under certificate of posting to the previous auditor informing him his appointment as an cost auditor before the commencement of audit by him.

(d) A Cost Accountant practicing in India enters into partnership with a CMA ,U.S.A.

(e) Q, a Cost Accountant had accepted appointment as an cost auditor of ABC Company Limited without ascertaining from the Company whether the requirement of Sections 224 and 225 of the Companies Act had been complied with. He realized this defect only after acceptance.

Answer 21. (a)

Clause (10) of Part I of the First Schedule to the Cost Accountants Act, 1959 prohibits a member in practice to engage in any business or occupation other than the profession of cost accountant unless permitted by the Council so to engage. Such prohibition has been introduced as it would not be in keeping with the dignity of the profession and may also enable the member to secure an unfair advantage in his professional practice. In the instant case, Mr. Y has accepted the appointment of lectureship without obtaining specific and prior approval of the Council. Accordingly, Mr. Y would be held guilty of professional misconduct.

Answer 21. (b)

The Council of the Institute had approved posting of particulars on website by Cost Accountants in practice under Clause (6) of Part I of First Schedule to the Cost Accountants Act, 1959 subject to the prescribed guidelines. The relevant guidelines in the context of the website hosted by M/s FBH are :

- No restriction on the colours used in the website;
- The websites are run on a "pull" technology and not a "push" technology
- Names of clients and fees charged not to be given.

In view of the above, M/s FBH would have no restriction on the colours used in the website but failed to satisfy the other two guidelines. Thus, the firm would be liable for professional misconduct since it would amount to soliciting work by advertisement.

Answer 21. (c)

Clause 8 of Part I of the First Schedule to the Cost Accountants Act, 1959 requires communication by the incoming auditor with the previous auditor before accepting a position by him. The Council of the Institute has taken the view that a mere posting of a letter "under certificate of posting" is not sufficient to establish communication with the retiring auditor unless there is some evidence to show that the letter has in fact reached the person communicated with. A Cost Accountant who relies solely upon a letter posted "under certificate of posting" therefore does so at his own risk. Since the letters were sent by "X" to the previous auditor informing him of his appointment as an auditor before the commencement of audit by him under Certificate of Posting is not sufficient to prove communication with the retiring auditor. In the opinion of the Council, communication by a letter sent "Registered Acknowledgement Due" or by hand against a written acknowledgement would in the normal course provide positive evidence. Hence "X" is guilty of professional misconduct under Clause (8) of Part I of First Schedule to the Cost Accountants Act, 1959.

Answer 21. (d)

As per MOU with IMA, USA a member of ICWAI can get enrolled as a member of IMA USA and vice versa. However, an IMA member enrolling as a member of ICWAI will not be allowed to hold a certificate of practice to undertake any statutory work in India. A Cost Accountant practising in India and entering into partnership with a CMA ,U.S.A. amounts to professional misconduct.

Answer 21. (e)

Clause 9 of the Part I of the First Schedule to the Cost Accountants Act, 1959 requires the auditor to ascertain from the company whether the relevant requirements have been complied with or not. However, in the instant case, "Q" a cost accountant, before acceptance of his appointment as an auditor has failed to ascertain whether the provisions of Sections 224 and 225 have been complied with by the company. The fact that "Q" has realised this defect only after acceptance would not save him from charge of misconduct. It is necessary for the incoming auditor to verify the relevant records of the company to enable him to ascertain whether the provisions of sections 224 and 225 have been complied with. Therefore, Q is guilty of professional misconduct under Clause (9) of Part I of First Schedule to the Cost Accountants Act, 1959.

Q. 22. Write short note on the following :

- **(a) Constitution and Functions of Audit Committee under Section 292A of the Companies Act, 1956.**
- **(b) Ministerial Conference.**

Answer 22. (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.

Answer 22. (b)

The Ministerial Conference (MC) is the highest body of World Trade Organisation. It is composed of all Members. The MC is responsible for carrying out all functions of the WTO. It has authority to take decisions in any matters under relevant Multilateral Trade Agreement. (MTA). The MC shall meet in every two years.

The MC has three functional committees for discharge of its functions assigned under MTA :

(a) Committee on Trade and Development.

(b) Committee on Balance-of –Payments Restrictions.

(c) Committee on Budget, Finance, and Administration.

The committees may establish additional committees with specific functions assigned to them.

Q. 23. (a) Enumerate the main areas to be covered by the auditor in the case of environment audit of an industrial unit.

(b) What are the key functions of an Energy Auditor?

Answer 23. (a)

Main areas to be covered in the case of environment audit of an industrial unit :

(i) Layout and design of the factory to provide for the installation pollution control devices with provision for upgradation of pollution control measures to meet regulatory authorities' requirements. Areas of deficiency to be included in the report.

(ii) The use of all resources such as air, water, land, energy, raw material and human resources with minimum waste and interlinking for best results to be looked into and reported.

(iii) It has to be reported whether all pollution control measures in vogue are effective with reference to the type of industry, nature of working and grade of polluting the environment.

(iv) Availability of adequate trained staff and safety amenities with provision for constant upgradation to be verified.

(v) Availability of adequate health care provisions and medical facilities for the workers to be looked into.

(vi) Availability of proper system to eliminate industrial unhygienic state.

(vii) Availability of adequate safeguard against occupational health hazards depending upon the nature of industry to be verified.

(viii) Existence of adequate information system and reporting of compliance of statutory legal provisions to the board at regular intervals to be verified.

(ix) Compliance of regularly mechanism by way of updating the existing environment system with the latest changes in the regulations to be looked into.

(x) It has to be verified as to how social aspects are addressed by the industry as they have an obligation to protect the society from pollution hazards of the industry.

Answer 23. (b)

Key functions of Energy Auditor :

Energy auditing is defined as an activity that serves the purposes of assessing energy use pattern of a factory or energy consuming equipment and identifying energy saving opportunities. 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.

Q. 24. (a) The newly appointed Chief Executive of a Company has asked you, as a Management Auditor, to give him a factual report, as to why his staffs are by and large demoralized.

(b) Explain the scope of concurrent audit of a bank with reference to Reserve Bank of India guidelines.

Answer 24. (a)

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.

Answer 24. (b)

Scope of concurrent audit of banks with reference to RBI guidelines :

(i) Daily cash transactions with reference to abnormal receipts and payments. This will include currency chest transactions, major expenses met by cash, high value receipts and disbursements.

(ii) Purchase and sale of shares, securities etc. Physical verification of investments and rates at which they are entered into.

(iii) Verification of procedure and documentation to open new current, savings, term deposit accounts, etc. Unusual operations noticed have to be thoroughly examined.

(iv) Verification of advances, overdrafts, temporary OD, Cash credit accounts, term loans, bills purchase, letters of credit etc. Procedure for sanction and documentation to be verified. Any deviation noticed to be examined in great detail.

(v) Foreign exchange transactions to be verified with reference to RBI guidelines.

(vi) Verification of balancing of all ledgers and registers, inter branch reconciliation calculation and verification of interest, discount, commission etc.

(vii) Revenue leakage to be detected.

(viii) Special efforts to be made in all fraud prone areas. The attempt should be to ensure that all effective measures are taken to prevent frauds.

(ix) Verification of high value transactions.

(x) Procedure for safe custody of security forms with the branch.

(xi) Whether all procedures for tax deduction at source are followed and the tax so deducted are deposited into Government Account within the time fixed.

(xii) Verification of returns, statements, calculation of capital adequacy ratio and compliance with requirements of government business.

(xiii) Study of RBI and Internal Inspection reports statutory auditors report and compliance thereto.

(xiv) Whether the customers' complaints are dealt with promptly.

Q. 25. (a) A company engaged in manufacturing of chemicals is consistently recording higher sales turnover, but declining net profits since the last 5 years. As a management auditor appointed to find out the reasons for the same, what are the points you would investigate?

(b) The Chief Commissioner of Customs has appointed you to carry out a Special Audit of Accounts of a company which manufactures goods in Customs Bonded Warehouse. What are the points you will cover in your report?

Answer 25. (a)

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 chemical 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 salesmix, 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.

Answer 25. (b)

The procedure for Special Audit of Accounts for goods manufactured in Bonded Warehouse has been laid down in the Board's regulations issued in 1966. The procedures have not been considerably simplified since then but physical control and supervision of customs officer on the bonded warehouse has been done away with since July 1998.

(i) The owner has to make an application giving full details of the description of warehouse, process of manufacture, imported and other goods used etc.

(ii) Manufacture or physical removal will not be under the supervision of the of the Custom officers but proper records should be maintained. The officers have right to visit the warehouse and control and supervise the process.

(iii) The basic records to be maintained are as follows :

(A) Bond register showing receipts and issues of goods.

(B) Issue Notes

(C) Manufacturing Register

(D) Finished product Register

(E) Reject /Scrap Register

(F) Export Register

(G) Subcontract Register

(H) DTA Sale Register

(I) Indigenous Goods Register

The Audit Report should cover the following :

(i) Basic information about the manufacturer like management controlling unit, capital structure, major raw materials, location of registered office and factories etc.

(ii) Details of manufacturing process and major capital equipment.

(iii) Input output ratios-norms vis-a- vis actual.

(iv) Documents checked

(v) Correlation of Customs documents of Input and Export of Final products with financial accounts.

(vi) The details of scrap sales.

(vii) Sales in Domestic Tariff Area (DTA)

(viii) Any other specific observation which is relevant for the audit.

However no comment should be made on admissibility or otherwise of any Cenvat credit, as it is the function of the adjudicating authority alone.

Q. 26. (a) 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.

(b) What is CFC? What type of work can be handled by CFC with regard to Central Excise & Service Tax under ACES Scheme?

Answer 26. (a)

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 in 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.

Answer 26. (b)

CFC stands for Certified Facilitation Centre under ACES project of CBEC and is an e-facility, which may be set-up and operated by a Cost Accountant in whole time practice to whom a certificate to act as CFC has been issued by ICWAI after approval by CBEC under the ACES project. Under this scheme the assessees of Central Excise and Service Tax can avail of this facility to file their returns and other documents electronically along with associated facilitation on payment of specified fees to Certified Facilitation Centre.

In respect of Central Excise, the works which can be handled by CFC are – Registration, Returns, Refunds & Rebate, Claims & Intimations, Provisional Assessments, Exports, Dispute Resolution and Audit.

Similarly, in respect of Service Tax, the works which can be handled by CFC are – Registration, Returns, Refunds, ST3A, Dispute Resolution and Audit.

Currently, under the ACES Scheme the following Returns can be filed by Cost Accountants in practice :

- Excel Utilities for Central Excise Returns - ER1, ER2, ER3, ER4, ER5, ER6 and Dealer's Return
- XML Scheme for Central Excise Returns - ER1, ER2 and Dealer's Return
- Excel Utility for Service Tax Return (ST3)

Further, the assessees can carry out many on-line transactions such as online registration, amendment to the registration form, filing of various claims, intimations, and permissions, refund claims, request for provisional assessment and export related documents. They can also file replies to show cause notices and appeals to Commissioner (Appeals).

Q. 27. Write short notes on :

(a) FICCI

(b) Sun Set Clause

(c) Customer Costing in Service Sectior.

Answer 27. (a)

FICCI : FICCI stands for Federation of Indian Chambers of Commerce and Industry. Established in 1927, FICCI is the largest and oldest apex business organisation in India. Its history is closely interwoven with India's struggle for independence and its subsequent emergence as one of the most rapidly growing economies globally. FICCI plays a leading role in policy debates that are at the forefront of social, economic and political change. Through its 400 professionals, FICCI is active in 39 sectors of the economy. FICCI's stand on policy issues is sought out by think tanks, governments and academia. Its publications are widely read for their in-depth research and policy prescriptions. FICCI has joint business councils with 79 countries around the world.

A non-government, not-for-profit organisation, FICCI is the voice of India's business and industry. FICCI has direct membership from the private as well as public sectors, including SMEs and MNCs, and an indirect membership of over 83,000 companies from regional chambers of commerce.

FICCI works closely with the government on policy issues, enhancing efficiency, competitiveness and expanding business opportunities for industry through a range of specialised services and global linkages. It also provides a platform for sector specific consensus building and networking.

Partnerships with countries across the world carry forward our initiatives in inclusive development, which encompass health, education, livelihood, governance, skill development, etc. FICCI serves as the first port of call for Indian industry and the international business community.

Answer 27. (b)

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. Counterveiling measures.

Answer 27. (c)

Customer Costing is a new approach to management and the central theme of this approach is customer satisfaction. In some service industries, such as public relations, the specific output of the industry may be difficult to identify and even more difficult to quantify. The variety of activities of a Bank for a customer can be cited in this regard. These are :

(i) Stopping cheque
(ii) Withdrawal of cash
(iii) Updation of pass book
(iv) Issue of duplicate pass book
(v) Cheque returns
(vi) Clearing of cheques.

For customer costing purpose, the cost are divided into following categories. These are :

(i) *Customer specific costs* — Like the cost of express conveyer to a client/customer who requests oversight delivery of some important document.
(ii) *Customer line categories* — These are the costs which are broken into the broad categories of customers and not individual customer.
(iii) *Company costs* — Those costs which are not allocated to either customer line or individual customers but charge to company. The example is the cost of advertisement to promote sale of service.

Q. 28. List the tasks that can be performed by a CMA in the following areas :

(a) Telecom Regulatory Authority of India (TRAI)
(b) Government Department
(c) Certification Work

Answer 28. (a)

Telecom Regulatory Authority of India (TRAI)

(i) Right to Legal Representation before Appellate Tribunal as per Section 17 of TRAI Act, 1997.
(i) Reporting and Audit for System on Accounting Separation- Certification Work.
(iii) Audit for Metering and Billing Accuracy- authorised to conduct audit.

Answer 28. (b)

Realising the importance of the profession of the Cost and Management Accountancy in the economic development of the nation, the Central Government has constituted an all-India cadre known as Indian Cost Accounts Service (ICAS) at par with other Class-I services such as IAS, IFS etc. to advise the government in cost pricing and in framing the appropriate fiscal and tax policies.

Answer 28. (c)

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 :

(i) Issuance of various certificates under Foreign Trade Policy 2009-14 and Aayat Niryat (Import and Export) Forms (ANF).

(ii) 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.

(iii) Certificate for Average Cost of transportation as per Rule 5 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000.

(iv) 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.

(v) 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.

(vi) Certificate of product wise position of production dispatches stock etc. for the year (Annexure III-A) under FICC.

(vii) 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.

(viii) Certificate of fulfillment of Hank Yarn obligation for Textile Industry and Textile Committee Cess-Monthly Return in Form-A.

(ix) Certifying half yearly return in Form ‘N’ for Quantity of Rubber purchased & consumed by manufacturers under rule 33 (f) of the Rubber Rules, 1955;

(x) Certifying Performa CI & C2 under Anti Dumping as prescribed by Ministry of Commerce;

(xi) Certifying Statement of cost of production for Anti-dumping petition to Government of India;

(xii) Certification of Application for License and renewal thereof to act as Surveyor and Loss Assessor under Insurance Regulatory and Development Authority (IRDA)

(xiii) Certification of various forms prescribed under the **Central Electricity Regulatory Commission (CERC).**

Q. 29. Write short notes on :

(a) QRB

(b) IAASB

Answer 29. (a)

QRB : Stands for Quality Review Board. The Government of India, Ministry of Corporate Affairs has set up a Quality Review Board to evaluate various services being provided by the members of the Institute vide Gazette Notification Number S.O. 1693 (E) dated 3rd October 2007. Section 29 A of the Cost and Works Accountants of India provides for establishment of Quality Review Board. Section 29 B of the Act relates to the functions of the Board. It provides that the Board shall perform the following functions :

(i) Make recommendations to the Council with regard to the quality of services provided by members of the Institute.

(ii) Guide the members of the Institute to improve the quality of services, provided by the members of the Institute including cost advisor services.

(iii) Review the quality of services and adherence to the various statutory and other regulatory requirements.

The constitution of QRB is therefore aimed at maintenance as well as enhancement of quality of attestation services or cost audit services and to provide guidance to members to improve performance. The quality review process is mainly focused on :

- Compliance with technical standards
- Quality of reporting
- Office System and procedures
- Training programmes for staff concerned including appropriate infrastructure.

Answer 29. (b)

IAASB : Stands for International Auditing and Assurance Standards Board. The IAASB develops auditing and assurance standards, other pronouncements, and guidance for use by professional accountants . The IAASB's objective is to serve the public interest by setting high-quality auditing and assurance standards and by facilitating the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world and strengthening public confidence in the global auditing and assurance profession. In fulfilling the above objective, the IAASB develops and issues the following :

- *International Standards on Auditing (ISAs)* and *International Standards on Review Engagements (ISREs)* to be applied in audit and review engagements on historical financial information.
- *International Standards on Assurance Engagements (ISAEs)* to be applied in assurance engagements other than audits or reviews of historical financial information.
- *International Standards on Related Services (ISRSs)* to be applied in related services engagements.
- *International Standards on Quality Control (ISQCs)* to be applied for all services falling within the engagement Standards of the IAASB.
- *Practice Statements* as appropriate to provide interpretive guidance and practical assistance in implementing the Standards of the IAASB and to promote good practice.

The IAASB also publishes other pronouncements on auditing and assurance matters, thereby advancing public understanding of the roles and responsibility of professional auditors and assurance service providers.

The IAASB develops auditing and assurance standards, other pronouncements, and guidance under a shared standard-setting process involving the Public Interest Oversight Board (PIOB). The PIOB oversees the work of the IAASB and its CAG to ensure that the activities of the IAASB are responsive to the public interest.

Q. 30. ADC Bank, a scheduled bank has received an application from an export company seeking sanction of a term loan to expand the existing sea food processing plant. The General Manager, (Advances) approaches you to conduct a thorough investigation of this limited company and submit a project report.
List out the points you will cover in your investigation before submitting your report to the General Manager.

Answer 30.

A bank is primarily interested in knowing the purpose for which a loan is required, the sources from which it would be repaid and the security that would be available to it, if the borrower fails to pay back the loan.

On these considerations, the management accountant, in the course of his enquiry, should attempt to collect information on the under mentioned points :

(i) Purpose for which the loan is required and the manner in which the borrower proposed to invest the amount of the loan.

(ii) Schedule of repayment of loan submitted by the borrower, particularly, the assumptions made therein as regards amounts of profits that will be earned in cash and the amount of cash that would be available for the repayment of loan to confirm that they are reasonable and valid in the circumstances of the case.

(iii) Financial standing and reputation for business integrity enjoyed by the directors and officers of the company.

(iv) Authorisation under Memorandum or the Articles of Association to borrow money for the purpose for which the loan will be used.

(v) History of growth and development of the company and its performance during the past five years.

To investigate the profitability of the business for judging the accuracy of the schedule of repayment furnished by the borrower, as well as the value of the security in the form of assets of the business already possessed and those which will be created out of the loan, the investigating accountant would be concentrating on the following points :

(a) Preparation of a condensed income statement from the Profit and Loss Accounts for the previous five years, showing separately therein various items of income and expenses, the amounts of gross and net profits earned and taxes paid annually during each of the five years. The amount of maintainable profits determined on the basis of foregoing statement should be increased by the amount by which these would increase on the investment of borrowed funds.

(b) Computation of under-mentioned ratios separately and then include them in the statement to show the trend as well as changes that have taken place in the financial position of the company :

   (i) Sales to Average Stocks held.

   (ii) Sales to Fixed Assets.

   (iii) Equity to Fixed Assets.

   (iv) Current Assets to Current Liabilities.

   (v) Quick Assets (the current assets that are readily realisable) to Quick Liabilities.

   (vi) Equity to Long Term Loans.

   (vii) Sales to Book Debts.

   (viii) Return on Capital Employed.

(c) Break-up of annual sales product-wise to show their trend.

(d) Schedule of assets and liabilities of the borrower including the particulars stated below :

   (i) ***Fixed assets*** **:** A full description of each item, its gross value, the rate at which depreciation has been charged and the total depreciation written off. In case the rate at which depreciation has been adjusted is inadequate, the fact should be stated. In case any asset is encumbered, the amount of the charge and its nature should be disclosed. In case an asset has been revalued recently, the amount by which the value of the asset has been decreased or increased on revaluation should be stated along with the date of revaluation. If considered necessary, he may also comment on the revaluation and its basis.

   (ii) ***Stocks*** **:** The value of different types of stocks held (raw materials, work-in-progress and finished goods) and the basis on which these have been valued. Details as regards the nature and composition of finished goods should be disclosed. Slow-moving or obsolete items should be separately stated along with the amounts of allowances, if any, made in their valuation. For assessing redundancy, the changes that have occurred in important items of stock subsequent to the date of the Balance Sheet, either due to conversion into finished goods or sale, should be considered. If any stock has been pledged as a security for a loan the amount of loan should be disclosed.

(iii) ***Sundry debtors, including bills receivable*** **:** Their composition should be disclosed to indicate the nature of different types of debts that are outstanding for recovery; also whether the debts were being collected within the period of credit as well as the fact whether any debts are considered bad or doubtful and the provision if any, that has been made against them. Further, the total amount outstanding at the close of the period should be segregated as time-period wise.

(iv) ***Investments*** **:** The schedule of investments should be prepared. It should disclose the -date of purchase, cost and the nominal and market value of each investment. If any investment is pledged as security for a loan, full particulars of the loan should be given.

(v) ***Secured Loans*** **:** Debentures and other loans should be included together in a separate schedule. Against the debentures and each secured loan, the amounts outstanding for payments along with due dates of payment should be shown. In case any debentures have been issued as a collateral security, the fact should be stated. Particulars of assets pledged or those on which a charge has been created for re-payment of a liability should be disclosed.

(vi) ***Provision of Taxation*** **:** The previous years up to which taxes have been assessed should be ascertained. If provision for taxes not assessed appears in be inadequate, the fact should be stated along with the extent of the shortfall.

(vii) ***Other Liabilities*** **:** It should be stated whether all the liabilities, actual and contingent, are correctly disclosed. Also, an analysis according to ages of trade creditors should be given to show that the company has been meeting its obligations in time and has not been depending on trade credit for its working capital requirements.

(viii) ***Insurance*** **:** A schedule of insurance policies giving details of risks covered, the date of payment of last premiums and their value should be attached as an annexure to the statements of assets, together with a report as to whether or not the insurance-cover appears to be adequate, having regard to the value of assets.

(ix) ***Contingent Liabilities*** **:** By making direct enquiries from the borrower company, from members of its staff, perusal of the files of parties to whom any loan has been advanced those of machinery suppliers and the legal adviser, for example, the investigating accountant should ascertain particulars of any contingent liabilities which have not been disclosed. In case, there are any, these should be included in a schedule and attached to the report.

(x) The impact on economic position of the company by economic, political and social changes that are likely to take place during the period of loan.