



FINAL EXAMINATION

SET - 1

MODEL ANSWER

TERM – DECEMBER 2023

PAPER – 17

SYLLABUS 2022

COST AND MANAGEMENT AUDIT

Time Allowed: 3 Hours

Full Marks: 100

The figures in the margin on the right side indicate full marks.
Answer Question No. 1 and any five from Question No. 2, 3, 4, 5, 6, 7 and 8.

SECTION – A (Compulsory)

1. Choose the correct alternative. [15 x 2=30]

- (i) The form in which cost records shall be maintained:
- CRA -1
 - CRA -2
 - CRA -3
 - CRA -4
- (ii) The Cost Auditing Standard which deals with Cost Audit Documentation:
- 101
 - 102
 - 103
 - 104
- (iii) The cost auditor of the company who is in default in compliance with section 148 shall be punishable in the manner as provided in:
- Section 139 of Companies Act, 2013
 - sub-sections (1) to (3) of section 148 of Companies Act, 2013
 - Section 143 of Companies Act, 2013
 - sub-sections (2) to (5) of section 147 of Companies Act, 2013
- (iv) The applicability of cost audit under Companies (Cost Records & Audit) – Rules, 2014 for regulated industries having overall annual turnover during immediate preceding financial year is:
- ₹ 25.00 crores
 - ₹ 35.00 crores
 - ₹ 50.00 crores or more
 - None of the above
- (v) A shoe manufacturing company has a plant capacity of producing 700 shoes per shift. During the year of 300 working days, 3 shifts of 8 hours with half-hour recess per shift, it produces 35.91 lakh shoes. The Normal Capacity Utilization percentage is:



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- a. 82%
- b. 76%
- c. 74%
- d. 78%

(vi) Remuneration of Non-Executive Director is treated as:

- a. Employee Costs
- b. Administrative Overhead
- c. Non-Cost item
- d. Selling and Distribution Overhead

(vii) Item appearing only in Cost Records is:

- a. Profit on Sale of Assets
- b. Interest Received
- c. Loss on Sale of Assets
- d. Notional Interest on Capital

(viii) CAS 21 deals with:

- a. Cost of Service Cost centre
- b. Quality control
- c. Capacity determination
- d. Cost Classification

(ix) Which one of the following KPI is used to measure productivity & efficiency of a machinery?

- a. % of Idle time to total available time
- b. Machine downtime ratio
- c. Production per man hour
- d. Contribution per unit of material used

(x) Which of these reports is written before starting a new project?

- a. Feasibility report
- b. Periodic report
- c. Trouble report
- d. Progress report

(xi) Parallel runs are used:

- a. During regular operation of an information system.



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- b. When a system is initially implemented
c. Whenever errors are found in a computerized system
d. Whenever management insists
- (xii) Which of the following is not likely to be a fraud risk factor relating to management characteristics?
a. Tax evasion
b. Failure to correct known weakness in internal control system
c. Adoption of conservative accounting principles
d. High management turnover
- (xiii) C&AG has right to direct how company's accounts shall be audited by the auditor and to give such auditor instructions in regard to any matter relating to the performance of his functions as per section:
a. 143 of the Companies Act, 2013
b. 134 of the Companies Act, 2013
c. 173 of the Companies Act, 2013
d. 44AB of the Income Tax Act, 1961
- (xiv) As per the study of ACFE, the following category of individuals commit the highest frauds (in monetary terms):
a. Low-level management
b. Mid-level management
c. Senior level management
d. All of the above
- (xv) "Payment System" as defined under the Prevention of Money Laundering Act, 2002 does include – (i) System enabling credit card operations, debit card operations (ii) smart card operations (iii) money transfer operations
a. Only (i)
b. Only (iii)
c. Only (i) & (iii)
d. All the above

Answer:

| | | | | | | | | | | | | | | |
|-----|------|-------|------|-----|------|-------|--------|------|-----|------|-------|--------|-------|------|
| (i) | (ii) | (iii) | (iv) | (v) | (vi) | (vii) | (viii) | (ix) | (x) | (xi) | (xii) | (xiii) | (xiv) | (xv) |
| a | b | d | c | b | b | d | b | b | a | b | c | a | c | d |



SECTION – B

Answer any “5” Questions from Question No. 2 to Question No. 8 in Section “B”. Each Question Carries 14 marks. [5x14= 70]

2. (a) Discuss the objectives of Cost Audit. [7]

Answer:

Cost Audit has both general and social objectives.

General Objectives:

- Verification of cost accounts with a view to ascertaining that these have been properly maintained and compiled according to the cost accounting system followed by the enterprise.
- Ensuring that prescribed procedures of the cost accounting records rules are duly adhered to.
- Detection of errors and fraud.
- Verification of the cost of each “cost unit” and “cost center” to ensure that these have been properly ascertained.
- Determination of inventory valuation.
- Facilitating the fixation of prices of goods and services.
- Periodical reconciliation between cost accounts and financial accounts.
- Ensuring optimum utilization of human, physical and financial resources of the enterprise.
- Detection and correction of abnormal loss of material and time.
- Advising management, on the basis of inter-unit/inter-firm comparison of cost records, as regards the areas where performance calls for improvement.
- Promoting corporate governance through various operational disclosures to the directors.
- Helping the entity in matters of Anti-Dumping Duty, valuation of cost of production of goods and services, anti-profiteering (e.g. GST), price controls (e.g. Pharma industry in the past), etc.



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Socials Objectives:

- Verifying whether the pricing of the products is justified as per the product and quality are concerned.
 - Removing the disparities, if any, in the pricing of products and/or services.
 - Looking into that no cost based economic imbalance may occur in product and /or services.
 - Facilitating in the global market cost competitiveness of the products.
 - Ensuring the efficient utilization of resources.
- (b) Classify the information which are required to be given in the Form CRA - 2 for intimation of appointment of Cost Auditor by the company to Central Government.

[7]

Answer:

The following information are required to be given in the Form CRA - 2 for intimation of appointment of Cost Auditor by the company to Central Government:

- (1) Corporate Identity Number (CIN) or Foreign Company Registration Number (FCRN) of the company
 - (2) General Information
 - (3) Product(s)/Service(s) to which Cost Audit relates
 - (4) Details of all the Cost Auditor(s) appointed
 - (5) Financial year to be covered under the Cost Audit
 - (6) Details of previous Cost Auditor which has not been reappointed
 - (7) Attachments
 - Copy of the Board resolution of the company
 - Optional attachment - if any
3. (a) As per Section 141(3), read with Rule 10 of Company (Audit and Auditor) Rule 2014, explain the persons who shall not be eligible for appointment as an auditor of a company.

[7]

Answer:

As per Section 141(3), read with Rule 10 of Company (Audit and Auditor) Rule 2014, the following persons shall not be eligible for appointment as an auditor of a company:

- (a) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;

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- (b) an officer or employee of the company;
- (c) a person who is a partner, or who is in the employment, of an officer or employee of the company;
- (d) a person who, or his relative or partner:
 - (i) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company, of face value not exceeding rupees one lakh;
 - (ii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of rupees five lakh;
 - (iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of rupees one lakh;
- (e) a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed;
- (f) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel;
- (g) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;
- (h) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;
- (i) a person who, directly or indirectly, renders any service referred to in Section 144 to the company or its holding company or its subsidiary company.

Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor [Section 141(4)].

- (b) Mention the steps are to be followed to file the reports in XBRL Format. [7]

Answer:

The following steps are to be followed in sequence to file the reports in XBRL Format:



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- (i) Mapping the individual cost elements of the company to the elements of the costing taxonomy.
- (ii) Populating the relevant data in the software/filing tool.
- (iii) Creating an XBRL instance document.
- (iv) Download XBRL validation tool.
- (v) Validating the instance document with the validation tool of MCA.
- (vi) Pre-scrutiny of the instance document.
- (vii) Use available tool to convert the instance document to a human readable pdf format and check correctness of data.
- (viii) Attaching the instance document to the e-Form and filing on MCA portal.
4. (a) Purchase of Materials \$ 50,000 [Forward contract rate \$ = ₹64.40 but \$ = ₹64.60 on the date of importation]; Import Duty paid ₹5,65,000; Freight inward ₹1,62,000; Insurance paid for import by road ₹48,000; Cash discount ₹33,000; Payment made to the foreign vendor after a month, on that date the rate of exchange was \$ = ₹65.20. Compute the landed cost of material. [7]

Answer:

Computation of Landed Cost of Material

| | Particulars | Amount (₹) |
|-----|---|-------------------|
| | Purchase price of Material [50,000 × 64.60] | 32,30,000 |
| Add | Import duties of purchasing the material | 5,65,000 |
| Add | Freight Inward during the procurement of material | 1,62,000 |
| Add | Insurance paid | 48,000 |
| | Value of Receipt of Material | 40,05,000 |

- (i) Excess payment made to the vendor due to exchange fluctuation is not an includible cost, hence not considered.
- (ii) Though the forward contract rate was \$ = ₹64.40, but the exchange rate on the date of importation is considered. Hence, included in the cost of materials. Accordingly, the purchase cost is computed considering the \$ = ₹64.60.



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- (b) GLORY LTD., a manufacturing company provides the following extracts from its Cost Accounting Records for the year ended March 31, 2023:

| | |
|--|---------------|
| The total capacity for 5 Machines per hour as per the company's specification. | 2500 Units |
| No. of shifts (each shift of 8 hours) per day | 3 |
| Paid holidays in a year (365 days): | |
| (i) Weekly holidays | 52 |
| (ii) Other holidays | 10 |
| Annual maintenance is done within these holidays (i.e. 10) | |
| Preventive maintenance for the machines is carried on during weekly off day. | |
| Normal idle capacity due to lunchtime, shift changes etc. per shift | 0.5 hour |
| Production based on sales expectancy in past 3 years (units in lakh): | 154.50 |
| | 159.54 |
| | 166.66 |
| Actual production for the year ended March 31, 2023: | 158.80 |

You are required to calculate:

- (1) Installed Capacity
- (2) Practical Capacity
- (3) Actual Capacity (%)
- (4) Normal Capacity
- (5) Idle Capacity (%)
- (6) Abnormal Capacity — Keeping in view of the relevant Cost Accounting Standard (CAS-2). [7]

Answer:

GLORY LTD.

CALCULATION OF DIFFERENT CAPACITIES FOR THE COMPANY

| | |
|-----|---|
| (1) | Installed Capacity : $365 \times 8 \times 3 \times 2500 = 21900000$ i.e. 219 lakh units |
| (2) | Practical capacity: $(365 - 52 - 10) \times (8 - 0.5) \times 3 \times 2500 = 17043750$ i.e. 170.4375 lakh units |
| (3) | Actual capacity (given) = 158.80 lakhs units |
| | Actual capacity utilization: $(158.80/219) \times 100 = 72.51\%$ |
| (4) | Normal Capacity: $(154.50 + 159.54 + 166.66)/3 = 160.23$ lakh units |
| (5) | Idle capacity: $(219 - 158.80) = 60.20$ lakh unit i.e. $(60.20/219) = 27.49\%$ |
| (6) | Abnormal Idle capacity: $(170.4375 - 158.80) = 11.6375$ lakh units i.e. $(11.6375/170.4375) = 6.83\%$. |



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5. (a) In the Financial Accounts of Chemicals & Fertilizers Ltd. for the year ended March 31, 2023 the profit was ₹ 8,98,07,500. The profit as per Cost Accounting records for the same period was less. The following details are extracted from the accounting schedules and Cost Accounting records of the company.

| | Financial Accounts ₹ '000 | Cost Accounts ₹ '000 |
|---------------------------------|------------------------------|-------------------------|
| Opening : Semi Finished Goods | 31700 | 35210 |
| : Finished Goods | 83220 | 78590 |
| Closing : Semi Finished Goods | 35260 | 39420 |
| : Finished Goods | 89320 | 80450 |
| Urea & Transport subsidy | 348 | |
| Expenses on CSR | 56 | |
| Profit on sale of Fixed Assets | 150 | |
| Chemical used internally | 382 | 365 |
| Favourable Exch. Rate variation | 294 | |
| Post-retirement Medical grant | 584 | |
| Purchase Tax Refund | 453 | |
| Litigation Recovery-Prior year | 125 | |

You are required to prepare a Reconciliation Statement and arrive at the Profit as per Cost Records for the year ended March 31, 2023. [7]

Answer:

Chemicals & Fertilizers Ltd.

Reconciliation of financial profit and costing profit for the year ended March 31, 2023

Amount in ₹ thousand

| Profit or loss as per Financial Accounts | | 8,9807.50 |
|--|-----------|------------|
| A. Less: Incomes not considered in Cost Accounts: | | |
| i. Profit on sale of Fixed Assets | 150 | |
| ii. Urea & Transport Subsidy | 348 | |
| iii. Litigation Recovery-Prior year | 125 | |
| iv. Favorable Exch. Rate Variation | 294 | |
| v. Purchase tax Refund | 453 | |
| vi. Own consumption (Chemicals) valuation difference (382-365) | <u>17</u> | (1,387.00) |



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| | | |
|---|------------|------------|
| B. Add: Expenses not considered in Cost Accounts | | |
| i. Expenses on CSR | 56 | |
| ii. Post-retirement medical grant | <u>584</u> | 640.00 |
| C. Less: Difference in Valuation of stock between Financial Accounts and Cost Accounts (9,660-6,070) (workings) | | (3,590.00) |
| Profit as per Cost Accounts | | 85,470.50 |

Workings:

Current Year (2022-23)

(Amount in ₹ thousand)

| | Financial Accounts | Cost Accounts |
|------------------------|--------------------|---------------|
| Opening Semi finished | 31,700 | 35,210 |
| Finished | 83,220 | 78,590 |
| Total | 1,14,920 | 1,13,800 |
| Closing semi finished | 35,260 | 39,420 |
| Finished | 89,320 | 80,450 |
| Total | 1,24,580 | 1,19,870 |
| Variation in inventory | 9,660 | 6,070 |

Increase in Difference of stock valuation towards financial accounts = ₹3,590

- (b) Discuss about the Investigation Methodology of Forensic Audit. [7]

Answer:

The forensic audit investigation is the utilization of specialized investigation skills to conduct the forensic audit engagements in such a manner that the outcome can be presented in a court of law as evidence. The auditor should use an approach considering both the aspects of whether the fraud could have occurred and whether the fraud could not have occurred. With this approach, the forensic auditors will be able to bring the reality closer to the general, public especially the circumstances where perception and reality are not aligned. An auditor can follow a nine-step method for fact-finding in case of forensic audit engagements:

- (i) Accept the forensic audit engagement.
- (ii) Evaluate the allegations or suspicions.
- (iii) Conduct due diligence background notes.



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- (iv) Complete the preliminary stage of the investigation.
- (v) Check the prediction assuming that there will be litigation.
- (vi) Begin with an external investigation.
- (vii) Gathering the required proofs and evidence.
- (viii) Preparing report on findings; and
- (ix) Court proceedings.

6. (a) Describe the features of Environmental Audit. [7]

Answer:

The following are the features of Environmental Audit:

- (i) **Role of Management:** Environmental audit performed through Internal Audit Team is generally considered as part of the internal control system and is mainly used to assess, evaluate and manage the environmental performance of a company including compliance against various legislations.
- (ii) **Environmental Impact Assessment (EIA):** EIA is a tool used to predict, evaluate and analyze environmental impacts w.r.t upcoming Projects, mostly before a project commences, expansion plans etc. Whereas environmental audit looks at environmental performance for an existing operation or activity with impact assessment on account of non-conformity.
- (iii) **Systematic:** Audit is a systematic carefully planned, structured, and organized end to end process to ensure adequacy and result orientation for the environmental concerns.
- (iv) **Documentation:** Like any other audit, the base of any environmental audit findings also needs to be backed-up and supported by proper documents and verifiable information. Management needs to ensure appropriate methods for environment related data collection and preservation, so that same can be perused for review and/or future reference purposes.
- (v) **Continuous Review:** Monitoring of environmental performance against regulations and/or benchmarking the same is a continuous process. Regular collection of actual measurement datum and review, finding out 'root cause' for deviations from norms set can help in timely intervention and taking steps.
- (vi) **Objective Evaluation:** Other than environmental performance and compliance against specific regulatory matters, at times accreditation, certification, taking part in environmental survey etc. also comes up with enhanced objectivity.



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(vii) **Environmental Performance:** The essence of any environmental audit is to find out how well the environmental management function performance in creating favourable impact and achieving organisational goal for environmental balance.

(b) Discuss about the necessity of Management Audit. [7]

Answer:

Management Audit has become necessary on account of the following reasons:

- (i) Management audit examines whether appropriate policies are laid down by the company management and the same being adhered through spirit and action.
- (ii) It helps in the improvement of the performance of management as a Team.
- (iii) Management audit suggests eliminating wastage and/or achievement of maximum with minimum.
- (iv) Independent appraisal of performance.
- (v) SWOT (Strength, Weakness, Opportunity and Threats) are analyzed for timely management intervention.
- (vi) Review of effectiveness w.r.t decision making process.
- (vii) Ensure good governance practice in every sphere of managerial activities.

7. (a) ABC Co. has planned for an investment of ₹800.00 lakh with a 50% Loan from Banks at 10% interest.

Direct Cost for the year ₹480.0 lakhs and 50% of which is Material cost. Other expenses are at ₹ 80.0 lakh. The goods will be sold at 150% of the direct cost. The tax rate is assumed at 50%.

Determine:

- (i) Net profit margin
- (ii) Return on Assets
- (iii) Assets turnover
- (iv) Return on owners' equity
- (v) Inventory Turnover

[7]



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Answer:

| Particulars | ₹ Lakhs / % |
|---|-------------|
| Sales: 480×1.5 | 720 |
| Direct Cost | 480 |
| Gross Profit | 240 |
| Operating Exp + interest | 120 |
| Profit before Tax | 120 |
| Net profit after Tax | 60 |
| (i) Net Profit Margin $(60/720)$ | 8.33% |
| (ii) Return on Assets $(60/800)$ | 7.5% |
| (iii) Return on Equity $(60/400)$ | 15% |
| (iv) Asset Turnover $(720/800)$ | 0.9 |
| (v) Inventory Turnover $(240/720) \times 100$ | 33.33% |

- (b) Align the strategies for Manpower Planning. [7]

Answer:**Strategies for manpower planning are as follows:**

- (i) Collection, maintenance, and interpretation of relevant information regarding human resources.
- (ii) Periodical review of manpower objectives and requirements.
- (iii) Development of procedures and techniques to determine the requirements of different types of manpower over some time.
- (iv) Development of measures for the utilisation of manpower along with independent validation, if possible.
- (v) Employment of suitable techniques for the effective allocation of work to improve manpower utilization properly.
- (vi) Conducting surveys for determining the factors hampering the contribution of individuals as well as of the groups in the organisation for modifying or removing those handicaps.
- (vii) Development and employment of methods of economic assessment of human resources, reflecting its features as an income generator and cost.

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- (viii) Evaluation of the procurement, promotion, retention, etc., of the effective manpower resources about the forecast of manpower requirements of the organisation.
- (ix) Analysis and controlling of organisational processes and structure for encouraging maximum individual and group performance without incurring excessive costs.

8. (a) Distinguish between Internal Audit and Operational Audit. [7]

Answer:

| Internal Audit | Operational Audit |
|--|---|
| 1. Compliance objective | Risk identification, process improvement objective |
| 2. Financial accounts focus | Business focus |
| 3. Audit focus | Efficiency & improvement focus |
| 4. Transaction-based | Process-based |
| 5. Policies and procedures focus | Risk management focus |
| 6. Cost Centre wise budget monitoring | Accountability for performance improvement results |
| 7. Methodology: Focus on policies, transactions and compliance | Methodology: Focus on goals, strategies and risk management processes |

(b) Identify the points which are to be considered necessary for conducting audit of Hospital. [7]

Answer:

The following points are to be considered necessary for conducting an audit of Hospital:

- (i) Check the letter of appointment to ascertain the scope of responsibilities.
- (ii) Ownership and control of the institution.
- (iii) Process (e.g., admission, release, outdoor check-up, pathology and other test facilities, Operation Theatre facility, vaccination etc.) and related controls till revenue generation. Normally facilities not provided for other than cash terms.



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- (iv) Donation, Special Grant, Interest and/ or dividend income etc. to be validated through necessary supporting documents, should be vouched with reference to the Investment Register and Interest and Dividend warrants.
- (v) Ensure purposive donations, grants etc. spent for the particular purpose only.
- (vi) Clear distinction should be made between the items of capital and revenue nature.
- (vii) Adherence to Standard Operating procedure w.r.t Expenses (Capex and Opex)
- (viii) Verify the system of internal check as regards purchases and issue of stores, medicines, medical equipment etc.
- (ix) Examine that the appointment of the staff, visiting specialist doctors, payment of salaries etc. for expenditure booking validation.
- (x) Physically verify the investments, fixed assets and inventories.
- (xi) Check appropriateness of capitalization and depreciation rates charged and value in Books.