

**Paper – 19 - Cost and Management Audit**

# Answer to MTP\_Final\_Syllabus 2012\_Jun 2017\_Set 1

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## Paper – 19 - Cost and Management Audit

Full Marks : 100

Time allowed: 3 hours

Answer Question No. 1 which is compulsory and carries 20 marks  
and any five from Question No. 2 to 8.

### Section A [20 marks]

1. Answer the following questions:

(a) Fill in the blanks:

[5×1=5]

- (i) Cost Audit was initially introduced in the year \_\_\_\_\_
- (ii) CAS 5 deals with \_\_\_\_\_
- (iii) \_\_\_\_\_ ensures that every rupee invested in capital or other fields gives optimum returns.
- (iv) The forex component of imported material is converted at the rate on \_\_\_\_\_
- (v) Para 4, Part A of the Annexure to Cost Audit Report deals with \_\_\_\_\_

(b) State whether the following statements are true or false:

[5×1=5]

- (i) The main emphasis of Management Audit is problem identification rather than problem solving.
- (ii) Under utilization of capacity has no impact on the Cost of Production of a product.
- (iii) Value addition is the difference between gross sales and the cost of bought out materials and services
- (iv) CAS 18 deals with Interest and Financing Charges.
- (v) XBRL is a language based on XML family of languages.

(c) Answer any five of the following in one or two sentences:

[5×2=10]

- (i) Which Companies are required to maintain Cost Records?
- (ii) Whether Value addition and distribution of earnings [part D, Para 3] is to be computed based on Cost record data or audited financial data?
- (iii) What do you understand by 'Net Sales Realisation' with reference to CAS 24?
- (iv) How would you treat demurrage charges as per CAS 15?
- (v) How you Employee Share Options would costs under Generally Accepted Cost Accounting Principles?
- (vi) What do corporate objectives represent?

Answer: 1(a)

- (i) 1965
- (ii) equalized cost of transportation
- (iii) Efficiency
- (iv) date of transaction
- (v) product/service details (for company as a whole)

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## Answer: 1(b)

- (i) True
- (ii) False
- (iii) False
- (iv) False
- (v) True.

## Answer: 1(c)

- (i) Any domestic or foreign company listed in Table of Rule 3, falling under regulated or non-regulated sectors and engaged in production of goods or provision of services with overall turnover from all its products or services is equal or more than ₹35 crores in preceding financial year is required to maintain Cost Records.
- (ii) Value Addition statement is to be computed based on audited financial accounts.
- (iii) Net Sales Realization: is the revenue from operations net of discounts and indirect taxes.
- (iv) As per CAS 15 relating to Selling and Distribution overheads, any demurrage or detention charges, or penalty levied by transportation or other authorities in respect of distribution activity shall not form part of the Selling and Distribution overhead.
- (v) Cost of employee share options is treated as part of employee cost provided the same is not a notional cost and involves an actual cash outlay.
- (vi) Corporate objectives represent the charter for the organization as laid down by itself. Corporate objectives are those that relate to the business as a whole. They are usually set by the top management of the business and they provide the focus for setting more detailed objectives for the main functional activities of the business.

## Section B [80 marks]

Answer any 5 questions from Question number 2 to 8. Each question carries 16 marks.

- 2 (a) The following information is extracted from the Cost Accounting Records of XYZ LTD. a Cement Company for the year ended March 31, 2017.

Production	96100 Tonnes
Norms for power consumption per tonne of cement	95 KWH
Total power generated/consumed:	
From the Electricity Board (EB) Grid.	52272540 KWH
From the Captive power plant.	62726720 KWH
From the Wind Mill (fed into the EB Grid and drawn at the factory site)	47044815 KWH
Cost of fuel consumed	44,39,26,234
Other operating costs of generating set.	₹ 2,84,81,558
Total operating cost of Wind Mill.	₹ 7,33,89,913

Note: The Electricity Board detects 10% of the Power fed into the Grid towards transmission losses.

Required:

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As a Cost Auditor of the Company, How will you present the above data in the Annexure to the Cost Audit Report under the Companies (Cost Records and Audit) Rules, 2014? [7]

2 (b) MNP TECHNO LTD. is a manufacturer of Ball and Roller bearings. In the Company four operations are carried on simultaneously in the manufacture of components.

The input/output data and Direct Wages Cost relating to the year 2016-17 for one component are as follows:

Operations	Gross Input (Tonnes)	Scrap (Tonnes)	Direct Wages (₹)
PM	48000	8000	12,40,000
QN	50000	10000	12,50,000
RA	72000	12000	23,60,000
SB	55000	5000	32,70,000

Material is introduced at start of Operation PM at a cost of ₹ 6,000 per tonne. Scrap can be sold at ₹ 500 per tonne. Overheads are absorbed at 150% on Direct Wages.

You are appointed as a cost consultant of MNP Techno Ltd. The company has not maintained cost records so far and seeks your advice in the matter.

Show your computation of the total cost per tonne of finished component so that the company can adopt the same in future. [9]

**Answer: 2 (a)**

XYZ LTD. Statement showing the cost of power consumed for the year ended March 31, 2017.

	Qty (KwH)	Rate (₹)	Amount (₹)
1. Power received from the Electricity Board (grid)	52272540	1.73	90431494
2. Self Generated			
(A) Captive Power Plant	62726720	2.27	142407792
(B) Wind mill (9% of generation)	42340334	1.73	73389913
Total	157339594	1.946	306229199

Production of Cement: 96100 Tonnes.

Actual Consumption of Power per Tonne: 1637.25

**Note:**

**Cost of Power received from Electricity Board (grid):**

It is assumed that the company purchased power from electricity board at the Wind Mill (fed to EB grid) rate i.e. ₹ 1.73 per KwH during the year 2014-15. Hence, cost of power will be ₹ 90431494.

### PART-B. PARA-2

ABRIDGED COST STATEMENT (for each product with CETA heading separately)

Name of Product			CEMENT			
CETA heading			2523; 6811 to 6812			
Unit of Measure			Tonne			
	Production	Finished stock adjustment	Captive consumption	Other adjustments	Quantity sold	
Current year	96100					

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SI No.	Particulars	Year 2014-15		Year 2013-14	
		Amount in ₹ Lakh	Rate per Unit (₹)	Amount (₹)	Rate per Unit (₹)
1	Materials consumed (specify details as per para 2A)	-			
2	Process Materials/Chemicals	-			
3	Utilities (specify details as per Para 2B)	3062.29	3186.57		
4	Direct Employees Cost				
5	Direct Expenses				
30	Cost of Sales (28+29)				
31	Net Sales Realisation (net of taxes and duties)				
32	Margin (Profit/Loss) as per Cost Accounts (31-30)				

### PARA- 2B

Details of utilities consumed		
Name of Product	CEMENT	
CETA heading	2523; 6811 to 6812	

SL No.	Description of material	UOM	Year 2014-15			Year 2013-14		
			Qty (KwH)	Rate per unit (₹)	Amount in (₹) lakhs	Qty	Rate per unit (₹)	Amount (₹ in lakh)
1.	Power	KwH	157339594	1.946	3062.29			
2.								
3.								

### Alternative :

#### Statement showing the cost of power consumed for the year ended March 31, 2017.

	Qty (KwH)	Rate (₹)	Amount
1. Power received from the Electricity Board (grid) (State Govt.)	52272540	-	-
2. Self Generated	62726720	2.27	142407792
(A) Captive Power Plant	42340334	1.73	73389913
(B) Wind mill (9% of generation)			
Total	157339594	1.372	215797705

Production of Cement: 96100 Tonnes.

Actual Consumption of Power per Tonne: 1637:25

#### Note:

Cost of Power received from Electricity Board (grid):

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It is assumed that state government provided free power (i.e. at zero rate) to the cement company as incentive for the industry during the year 2016-17. Hence, cost of power will be zero/nil.

### PART-B. PARA-2

(ABRIDGED COST STATEMENT (for each product with CETA heading separately)

Name of Product

Name of Product			CEMENT		
CETA heading			2523; 6811 to 6812		
Unit of Measure			Tonne		
	Production	Finished stock adjustment	Captive consumption	Other adjustments	Quantity sold
Current year		96100			
Previous year					

Sl No.	Particulars	Year 2016-17		Year 2015-16	
		Amount in ₹ Lakh	Rate per Unit (₹)	Amount (₹)	Rate per Unit (₹)
1	Materials consumed (specify details as per para 2A)	-			
2	Process Materials/Chemicals	-			
3	Utilities (specify details as per Para 2B)	2157.98	2245.55		
4	Direct Employees Cost				
5	Direct Expenses				
30	Cost of Sales (28+29)				
31	Net Sales Realisation (net of taxes and duties)				
32	Margin (Profit/Loss) as per Cost Accounts (31-30)				

### PARA- 2B

Details of utilities consumed		
Name of Product		CEMENT
CETA heading		2523; 6811 to 6812

SL No.	Description of material	UOM	Year 2016-17			Year 2014-15		
			Qty (KwH)	Rate per unit (₹)	Amount in (₹) lakhs	Qty	Rate per unit (₹)	Amount (₹ in lakh)
1.	Power	KwH	157339594	1.372	2157.98			
2.	.....							
3.	.....							

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**Answer: 2 (b)**

## MNP TECHNO LTD.

It is a fact that the company is not maintaining proper records. Cost per tonne of finished component is required to be worked out within the existing constraint of stage wise conversion cost and raw material identification to operation -PM

Stage-wise conversion cost, therefore to be converted to final cost using the multiplier or weight age factor. For converting Direct wages to conversion cost from the given data, following steps should be followed:

Let us assume. Direct wages	₹ 100
Overheads (150% of Direct wages)	<u>₹ 150</u>
Total conversion cost	<u>₹ 250</u>

Conversion cost is 2.50 times of Direct Wages:

Operation	Input tonnes in thousand	Output, tonnes in thousand	Multiplier factor (2/3)	Conversion cost (₹ in lakh) D.W. x 2.5	Conversion cost per Tonne (5/3) (₹)	Cumulative conversion cost per tonne (₹)
1	2	3	4	5	6	7
PM	48	40	1.20	31.00	77.50	77.50
QN	50	40	1.25	31.25	78.12	175.00
RA	72	60	1.20	59.00	98.33	308.33
SB	55	50	1.10	81.75	163.50	502.66

### Calculations:

(i) Cumulative conversion costs are:

$$\text{Operation QN} = (\text{₹ } 77.50 \times 1.25) + 78.12 = \text{₹ } 175.00$$

$$\text{Operation RA} = (\text{₹ } 175.00 \times 1.20) + 98.33 = \text{₹ } 308.133$$

$$\text{Operation SB} = (\text{₹ } 308.33 \times 1.10) + 163.50 = \text{₹ } 502.66$$

₹ 502.66 per tonne is the final stage conversion cost.

(ii) Raw material cost is:

= Cost of material quantity introduced at operation

= Material quantity × Rate per Tonne

= Product of multiplier factors × rate per tonne

$$= (1.20 \times 1.25 \times 1.20 \times 1.10 \times \text{₹ } 6000)$$

$$= 1.98 \times \text{₹ } 6000 = \text{₹ } 11880$$

Thus input = 1.98 tonnes Output = 1.00 Tonne Scrap = 0.98 Tonne

(iii) Value of Scrap = 0.98 tonne × ₹ 500 = ₹ 490

Computation of Total cost per Tonne of finished component

Material cost	₹ 11,880.00
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Less: Scrap Value	<u>(-) 490.00</u>
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₹	11,390.00
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Add: Conversion cost (table above)	<u>502.66</u>
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Total cost	<u>₹ 11,892.66</u>
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3 (a) The financial profit and loss account for the year 2016-17 of a company shows a net profit of ₹52,56,000. During the course of cost audit, it was noticed that:

- (i) The ₹10,00,000 after incurring and expenditure of ₹50,000.
- (ii) Some old assets sold off at the end-end fetching a profit of ₹160,000
- (iii) A major overhaul of machinery was carried out at a cost of ₹8,00,000. And the next such overhaul will be done only after four years.
- (iv) Interest was received amounting to ₹3,00,000 from outside investments.
- (v) Work-in-progress valuation for financial accounts does not as a practice take into account factory overhead. Factory overhead was ₹3,70,000 in opening WIP and ₹6,30,000 in closing WIP.

Work out the profit as per Cost Accounts and briefly explain the adjustment, if any, carried out. [8]

3 (b) The following particulars pertaining to product AZ are extracted from the record of SHINJIN LTD. for the half year ended March 31, 2017.

	Amount in ₹ Thousand
Direct Material Cost	827
Direct Wages and Salaries	200
Indirect Materials	75
Direct Expenses	100
Factory overheads	200
Administrative overheads (20% relating to production activities)	100
Quality Control Cost	25
Research and Development Cost	25
Selling and Distribution Expenses	15
Sale of Scrap realised	20
Material Cost includes Excise duty paid	27
Actual Profit Margin	15%

You are required to determine:

- (i) The Cost of production for purpose of CAPTIVE CONSUMPTION in terms of Rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules 2000 and as per CAS-4 and
- (ii) Also Assessable value for the purpose of paying excise duty on Captive Consumption.

[6+2=8]

Answer: 3 (a)

### Reconciliation Statement

Particulars	₹	₹
Profit as per Financial Profit & Loss Account		5256000
Less: Trading profit not included in cost accounts	150000	
Less: Profit on sale of old assets	160000	
Less: Interest received on outside investment	300000	610000
Add: Proportionate Charge i.e., three-fourth for	600000	



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overhaul of machinery not provided in cost accounts		
Add: Difference in the valuation of work-in-progress	260000	860000
Profit as per Cost Accounts		<b>5506000</b>

**Answer: 3 (b)**

### SHINJIN LTD. Computation of cost of production (As per -CAS-4)

(Amount in ₹ Thousand)

Direct materials (exclusive of excise duty) (827-27)	800
Direct wages & salaries	200
Direct expenses	100
Factory overheads (200+75)	275
Quality control cost	25
Research and development cost	25
Administrative overheads (to the extent relates to Production activity)	20
Less: Sale of scrap realized	<u>(20)</u>
<b>Cost of production</b>	<b>1425</b>
Add: 10% as per Rule 8 of CEV (DPOEG) Rules (10% of 1425)	<u>142.50</u>
<b>Assessable value as per Rule 8 of the CE Valuation (DPOEG) Rules 2001</b>	<b>1567.50</b>

**4 (a)** You are the Cost Auditor of MERLIN TEXTILE MILLS LTD. for the year ended March 31, 2017.

The Company had a Strike from 16.09.2016 to 19.11.2016. Although the company resumed working from 20.11.2016 normal production was achieved only from 08.12.2016. The expenses incurred during the year ended March 31, 2017 were

Amount in ₹ Lakh

Salaries and Wages (Direct)	1,800
Salaries and Wages (Indirect)	1,200
Power (Variable-90%)	600
Depreciation	1,080
Other fixed expenses	1,320
Repairs and Maintenance (Variable-80%)	600

Detailed examination of the records reveals that of the above, the following relate to the period 16.09.2016 to 19.11.2016.

Amount in ₹ Lakh

Salaries and Wages (Direct)	Nil
Salaries and Wages (Indirect)	480
Depreciation (Non-productive)	300
Other fixed expenses	<u>660</u>
	<b>1,440</b>

**Required:**

Calculate the amount which in your opinion should be treated as abnormal for exclusion from the product costs. [8]

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- 4 (b) The extracts of Trial Balance of PANCHAL LTD. a manufacturing company pertaining to employees as on March 31, 2015 are given below:

Particulars	Amount
Debit	₹
Salaries Cost	25,45,785
Employees Training Cost	4,73,000
Employees Selection Expenses	2,25,000
Perquisites –To Employees	12,45,000
Contribution to Gratuity Fund	5,25,000
Lease rental for accommodation provided to employees	3,25,000
Festival Bonus	1,25,000
Unamortised amount of Employee Cost related to a Discontinued operation	1,85,000
Employer's contribution to P.F. including Penalties ₹ 35,000	2,75,325
Free accommodation to own employees	
Depreciation	1,00,000
Municipal Tax	5,5,000
Maintenance	45,000
Credit	
Special subsidy received from Government towards employees salary	1,75,000
Recoverable amount from employee out of perquisites extended	35,000

**Required:**

- (i) Calculate the Employees cost for the year ended March 31, 2015—Keeping in view of cost Accounting Standard (CAS)-7.
- (ii) Specify the disclosures required. [5+3=8]

**Answer: 4 (a)**

### MERLIN TEXTILE MILLS LTD.

#### CALCULATION OF FIXED EXPENSES INCURRED DURING THE PERIOD 20.11.2016 TO 07.12.2016

		(Amount in ₹ Lakh)
Total Expenses for 2014-15		6600
Less: Variable expenses		
Power (90% of 600)	540	
Repairs & Maintenance (80% of 600)	480	1020
Total fixed expenses during 2016-17		5580
Less: Fixed expenses during strike period:		1440
(16.09.2016 to 19.11.2016)		—
Fixed Expenses during Non-strike period		<u>4140</u>

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'Since strike period was for 65 days (16.09.2016 to 19.11.2016), the non-strike period is 300 days. Hence fixed expenses attributed to 18 days i.e. 20.11.2016 to 07.12.2016 is 6% (18/300) of ₹ 4140 = ₹ 248.40 lakh

	<b>(Amount in ₹ Lakh)</b>
Expenses (fixed) incurred during the period of 16.09.16 to 19.11.16	1440.00
Expenses (fixed) incurred during the period of 20.11.16 to 07.12.16.	<u>248.40</u>
Total	<b><u>1688.40</u></b>

Hence, the amount to the tune of ₹1688.40 lakh is to be treated as abnormal cost and should be excluded from the product cost.

### **Answer: 4 (b) (i)**

Calculation of employee cost for the year ended March 31, 2017.

	<b>Amount (₹)</b>
1. Salaries	25,45,785
2. Perquisites to Employees less amount recoverable from Employee (₹ 12,45,000 - ₹35,000)	12,10,000
3. Contribution to Gratuity Fund	5,25,000
4. Less rental for accommodation	3,25,000
5. Festival Bonus	1,25,000
6. Employer's contribution to P.F.	2,40,325
7. Free accommodation to own employees	
Depreciation	1,00,000
Municipal tax	5,500
Maintenance	45,000
8. Less: Special subsidy received from Government towards Employee salary	<u>(1,75,000)</u>
	<b><u>49,46,610</u></b>

### **(ii) Disclosures:**

1. Recoverable amount of perquisites is excluded from cost of perquisites.
2. Employees training cost and selection expenses is not an employee cost. They are to treated as overhead, hence not included.
3. Special Govt, subsidy received to be used as reduction in the cost to employer.
4. Unamortised amount of employees cost related to discontinued operation is not includible item of cost
5. Penalties paid to P.F. authorities is not a normal expenditure are to be excluded from Contribution to P.F.
6. Assumed that the entire accommodation is exclusively used b the employees. Hence cost of accommodation provided includes all relevant expenses/costs as these are identifiable/traceable to the cost centre.

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- 5 (a) The following data have been obtained from the records of a machine shop for an average month.

	Budget
No. Of working days	25
Working hours per day	8
No. of direct workers	16
Efficiency	One standard hour per clock hour
Down time	20%
Fixed Overhead	₹ 15360
Variable Overhead	₹ 20480
<b>The actual data for month of September 2016 are as under:</b>	
Fixed Overhead	₹16500
Variable Overhead	₹14500
Net operator hours worked	1920
Standard hours produced	2112

There was a special holiday in September 2016. Required to present following cost ratios to present report to Departmental Manager:

- i) Efficiency ratio
- ii) Activity ratio
- iii) Capacity utilization ratio
- iv) Capacity usage ratio
- v) Idle capacity ratio
- vi) Calendar ratio

[1+2+1+2+1+1=8]

- 5 (b) What do you understand by 'energy audit'? Briefly state the functions of energy auditor.

[8]

**Answer: 5 (a)**

- (i) Efficiency ratio =  $(\text{Standard hours produced}) / (\text{Actual hours worked}) * 100$   
 $= (2112 / 1920) * 100 = 110\%$
- (ii) Budgeted Hours =  $(25 * 8 * 16) * 80\% = 2560$   
 Activity Ratio =  $\text{Standard Hours} / \text{Budgeted Hours} = 2112 / 2560 * 100 = 82.5\%$
- (iii) Capacity Utilization ratio =  $(\text{actual hours} / \text{budgeted hours}) * 100$   
 $= 1920 / 2560 * 100 = 75\%$
- (iv) Capacity usage ratio =  $(\text{Budgeted hours} / \text{maximum possible hours}) * 100$   
 $= 2560 / 3200 * 100 = 80\%$
- (v) Idle capacity ratio =  $100\% - 80\% = 20\%$
- (vi) Calendar ratio =  $\text{Actual days} / \text{budgeted days} * 100$   
 $= 24 / 25 * 100 = 96\%$

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## Answer: 5 (b)

Energy Audit is the key to a systematic approach for decision-making in the area of energy management. It attempts to balance the total energy inputs with its use, and serves to identify all the energy streams in a facility. It quantifies energy usage according to its discrete functions. Industrial energy audit is an effective tool in defining and pursuing comprehensive energy management programme.

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

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

- (i) Quantification of energy costs and quantities
- (ii) To correlate trends of production or activity to energy cost.
- (iii) To devise energy database formats to depict to correct picture – By product, department or consumer.

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

- (i) To analyse the historical energy consumption and cost data.
- (ii) To conduct preliminary energy audit with the objectives to identify:
  - (a) Major energy consuming equipment and process;
  - (b) Obvious inefficiencies and energy wastes; and
  - (c) Priority areas for further detailed investigation.
- (iii) To conduct detailed technical and economic analysis of energy efficiency measures involving large efficiency measures involving large capital investment or long payback periods.

**6 (a) GOLDEN FIBRE LTD. producing Jute goods wants to participate in the 'Swachh Bharat Mission' of Government of India. Discuss about the social commitment of the corporate towards Environment pollution control and the treatment of costs as per CAS-14.**

[8]

**(b) ABUNA ELECTRONICS LTD. is engaged in the manufacture of LED TV sets having its factories at Patna and Gujarat. The company manufactures picture tube at Patna which is consumed to produce LED TV sets at Gujarat factory. The following information pertaining to captively consumed picture tubes are extracted from the records of the company for the Half year ended March 31, 2016.**

(Amount in ₹Thousand)

<b>Direct material inclusive of excise duty ₹ 94 thousand</b>	<b>1,044</b>
<b>Direct wages and salaries</b>	<b>357</b>
<b>Direct expenses</b>	<b>80</b>
<b>Indirect materials</b>	<b>70</b>

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<b>Factory overheads</b>	<b>320</b>
<b>Administrative overheads (20% relating to production activities)</b>	<b>640</b>
<b>Quality control cost</b>	<b>100</b>
<b>Research and development cost</b>	<b>125</b>
<b>Selling and distribution expenses</b>	<b>225</b>
<b>Sale of scrap realised</b>	<b>130</b>
<b>Profit margin</b>	<b>15%</b>

You are required to determine:

- (i) **The cost of production for purpose of captive consumption in terms of Rule-8 of the Central Excise Valuation (Determination of price of Excisable Goods) Rules and as per CAS-4, and**
- (ii) **Also Assessable Value for the purpose of paying excise duty on Captive Consumption.**

**[6+2=8]**

**Answer: 6 (a)**

As per cas-14, pollution control means the control of emissions and effluents into environment. It constitutes the use of materials, processes, or practices to reduce, minimize, or eliminate the creation of pollutants or wastes. It includes practices that reduce the use of toxic or hazardous materials, energy, water, and / or other resources. Pollution is thus a kind of interference to the environment degradation. The problems of such environmental degradation - air, water, noise pollution, solid wastes, radiation hazards, thermal pollution, are threats to wildlife, depletion and destruction of natural resources, etc. Are all environmental crisis and threats affecting the delicate balance of natural ecosystem?

**The company producing** jute goods belongs to low income labour intensive industry. The workforce resides in and around the factory premises. The level of pollution varies with the density of population and per capita income and inversely with the extent of recycling, technology and waste treatment. The different types, cause and effects of environmental pollution may be in the nature of

- (i) **Air pollution** Which is the human introduction into the atmosphere of chemicals, particulates or biological materials that cause harm or discomfort to humans or other living organisms or damage the environment,
- (ii) **Water pollution:** Due to unsanitary way of living, there is the contamination of water bodies. Water pollution affects public health and safety, causes damage to property and leads to many economic losses,
- (iii) **Smell pollution:** Discharge of human soils openly, unclear garbage dumps, open sewers, etc. Affect physical well-being and even causes psychological disorders.

**Swatch Bharat Mission** is a comprehensive rural sanitation program launched by government of India and many corporate have supported construction of new toilets as a part of corporate social responsibility commitment enjoined in the companies act, 2013. Any expenditure on this account amount to 'social costs of pollution control' and the treatment of such costs are outlined in cas 14 as follows:

- Social costs of pollution are measured by economic models of cost measurement. The cost statement shall carry a reference to a descriptive note dealing with the social cost of pollution caused by the entity and the control of such pollution.
- Where the pollution control cost is not directly traceable to cost object, it shall be treated as overhead and assigned based on either of the principles of (i) cause and effect (ii) benefits received.
- Where estimates are made of future costs to be incurred on pollution control, the basis of

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estimate shall be disclosed separately.

**Answer: 6 (b)**

**ABUNA ELECTRONIC LTD.**

**(Amount in ₹ thousand)**

Direct materials (exclusive of excise duty (1044-94))	950
Direct wages and salaries	357
Direct expenses	80
Factory overheads (320+70)	390
Quality control cost	100
Research and development cost	125
Administrative overheads (to the extent relates to production activities)	128
Less: sale of scrap realised	(130)
Cost of production	<b>2000</b>
Add: 10% as per rule 8 of cev (dpeg) rules (10% of 2000)	200
Assessable value as per rule 8 of the cev (dpeg) rules	<b>2200</b>

**7 (a) SAFA organised a three-day International Conference of Accountants in Bangalore. You are asked to conduct internal audit the accounts of the conference. Draft the internal audit programme for audit of receipt of participation fees from delegates to the conference.**

[9]

**7 (b) As per Companies Act 2013 which companies are required to conduct Internal Audit? Who can be internal auditor as per the Act?**

[7]

**Answer: 7 (a)**

## Audit of Receipts of Participation Fees

The organization of three-day International Conference of Accountants in Bangalore by SAFA is a one-time event. Normally, in view of mega-size of the event, a special cell is made in the organization to handle the entire event. Since few people would be handling the event, the internal controls may not be that strong and, thus, more emphasis is required to be given on substantive procedure. Audit of receipt of participation fees should be under the following areas:

### **(I) Internal Control System**

- (i) Examine the organization structure of special cell created for the International Conference, if any, and division of responsibilities amongst persons and control/custody over receipt books.
- (ii) Verify the internal control system for restricting the participation of unregistered delegates.

### **(II) Rate of Participation Fees**

- (i) Verify with reference to resolution passed by the Organizing Committee/SAFA.
- (ii) Also verify the rate from the literature/registration form circulated for promotion of conference.

### **(III) Receipts of Participation Fees**

- (i) Verify counter foil of the receipts issued for individual registration.
- (ii) Ensure that receipts are issued for all the registration received in cash.
- (iii) Trace the receipts in Bank Statement or Cash Book – as the case may be.

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- (iv) Verify Bank Reconciliation Statement and list out dishonored cheques.
- (v) Verify subsequent recovery in respect of dishonoured cheques.

### (IV) Overall Checking

- (i) Verify the total receipts of participation fees shown in the financial statements with reference to total number of receipts issued to participants.
- (ii) Cross check the total number of delegates with reference to the following:
  - (a) Kits distributed to participants.
  - (b) Bill of caterer for providing meals during conference.
  - (c) Capacity of the Hall.
  - (d) Participation Certificate if any issued.

(V) Foreign Delegates: In case of foreign delegates – if registration fees are higher – ensure that they are registered at higher fees.

### (VI) Special Issues :

- (i) Take out list of absentees and in case of nil absentees, probe the issue further.
- (ii) If certain participants are exempted from payment of fees – obtain the list along with proper authorization in this regard.

### Answer: 7 (b)

Section 138 of the Companies Act 2013 read with rule 13 - companies(accounts) rules, 2014 states that the following class of companies shall be required to appoint an internal auditor or a firm of internal auditors, namely:-

(a) Every listed company;

(b) Every unlisted public company having-

- (i) Paid up share wealth of fifty crore rupees or more during the preceding financial year; or
- (ii) Turnover of two hundred crore rupees or more during the preceding financial year; or
- (iii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
- (iv) outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and

(c) Every private company having-

- (i) Turnover of two hundred crore rupees or more during the preceding financial year; or
- (ii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year:

Provided that an existing company covered under any of the above criteria shall comply with the requirements of section 138 and this rule within six months of commencement of such section.

Section 138 of the companies act 2013 deals with provisions of internal audit. As per section 138, (1) Such class or classes of companies as may be prescribed shall be required to appoint an internal auditor, who shall either be a chartered accountant **or a cost accountant**, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.



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**8. (a) What is meant by "Corporate Services Audit"?**

**Describe the areas of the "Corporate Services Audit", the scrutiny thereof and evaluation criteria used in the Audit. [2+6=8]**

**(b) Write a note on "Audit Committee" under the Companies Act, 2013 in brief. [8]**

**Answer: 8 (a)**

With the enlarged role assumed by corporate organization in this country, the corporate bodies are expected to have better social responsibilities than in the past. The term "Corporate Services" refer to the activities that combine or consolidate certain enterprise- wide needed support services, provided based on specialized knowledge, best practices, and technology to serve internal (and sometimes external) customers and business partners viz. employees, shareholders, community, fellow businessman and Government. Management Auditor studies separately and properly, evaluate after critically examination of the different aspects of services and their extent that have been satisfactorily rendered by the corporate body and of evaluation of degrees of responsiveness and awareness on the part of such enterprise.

The areas of Corporate Service Audits are:

- Consumers - Quality goods in right qualities at right price, place and time.
- Employees - Pay, training, safety, welfare, industrial relations, etc.
- Shareholders - Safety of investment, satisfactory return, appreciation (in Value & Quantity & marketability)
- Community - Social Cost and Social benefit, public relations.
- Fellow - Business ethics and fair trade dealings.

Businessmen

- State/Government - Compliance with, the spirit of laws, fair trade practices, payment of taxes.

Auditor should consider the level of contribution a business entity makes to society and its business environment towards raising the quality of life through better product quality and services rather than profit maximization. So, it is an appraisal by the auditor as referred above and auditor's responsibilities lies in evaluating the company's response to social needs.

**Answer: 8 (b)** Under section 177 of the Companies Act, 2013,

- (1) The Board of Directors of every listed company and such other class or classes of companies, as may be prescribed, shall constitute an Audit Committee.
- (2) The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority.

Provided that majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand, the financial statement.

- (3) Every Audit Committee of a company existing immediately before the commencement of this act shall, within one year of such commencement, be reconstituted in accordance with subsection (2).
- (4) Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall inter alia, include,—
  - (i) The recommendation for appointment, remuneration and terms of appointment of auditors of the company;

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- (ii) Review and monitor the auditor's independence and performance, and effectiveness of audit process;
  - (iii) Examination of the financial statement and the auditors' report thereon;
  - (iv) Approval or any subsequent modification of transactions of the company with related parties;
  - (v) Scrutiny of inter-corporate loans and investments;
  - (vi) Valuation of Undertakings Or Assets of the Company, wherever it is necessary;
  - (vii) Evaluation of internal financial controls and risk management systems;
  - (viii) Monitoring the end use of funds raised through public offers and related matters.
- (5) The Audit Committee may call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.
- (6) The audit committee shall have authority to investigate into any matter in relation to the items specified in sub-section (4) or referred to it by the Board and for this purpose shall have power to obtain professional advice from external sources and have full access to information contained in the records of the company.
- (7) The auditors of a company and the key managerial personnel shall have a right to be heard in the meetings of the Audit Committee when it considers the Auditor's Report but shall not have the right to vote.
- (8) The Board's report under sub-section (3) of section 134 shall disclose the composition of an Audit Committee and where the Board had not accepted any recommendation of the Audit Committee, the same shall be disclosed in such report along with the reasons therefore.
- (9) Every listed company or such class or classes of companies, as may be prescribed, shall establish a vigil mechanism for directors and employees to report genuine concerns in such manner as may be prescribed.
- (10) The vigil mechanism under sub-section (9) shall provide for adequate safeguards against victimisation of persons who use such mechanism and make provision for direct access to the Chairperson of the Audit Committee in appropriate or exceptional cases.

Provided that the details of establishment of such mechanism shall be disclosed by the company on its website, if any, and in the Board's report.