Paper – 17
Cost Audit & Operational Audit

Question 1:

(i) State the meaning of Captive Consumption. What types of goods covered under CAS-4?

(ii) As a Cost Auditor of a company how would you dealt with treat the head office expenses of a company?

Answer:

(i) Meaning of Captive Consumption:

"Captive Consumption" means that the goods are not sold by the assessee but are used for consumption by him or on his behalf in the production or manufacture of other articles in the same premises or elsewhere.

When goods manufactured are supplied to a related party who does not sell the goods but consumes the same in manufacture of another product(s), such goods are also deemed to be "captively consumed" for the purpose of valuation under Excise Laws.

In some cases during the manufacture, certain intermediate goods emerge and are used in manufacture/production of other goods. The use of such intermediate product within the factory is also termed as "Captive Consumption".

Sometimes the goods are not removed from the factory but are used in the further manufacture/production of goods and in such cases also, duty is payable as soon as the goods are manufactured/produced within the factory unless exempted. Goods captively consumed in the same factory of the manufacturer are exempted from duty as per Notification No. 67/95-CE dt.16.03.1995, if duty is payable on the final product. For example, the manufacturer of motor vehicles manufactures various parts of the motor vehicles like brakes, panels etc. These parts are also excisable goods and have separate entry in the schedule to Central Excise Tariff Act, 1985. If these parts are removed from the factory, duty is payable but if these parts are used in the same factory of the manufacturer in the assembly / further manufacture of motor vehicles then the use of parts and components is called as captive consumption, and is not subject to excise duty in view of above notification.

Type of Goods:

Following type of goods are covered under CAS-4:

1. Goods manufactured not sold but captively consumed
2. Goods manufactured partly sold and partly captively consumed
3. Goods manufactured sold to related party for captive consumption

(ii) Treatment of Head Office/Corporate Office Expenses:

A company may have a number of factories with a head office. In a multi-locational/ multi-product company, there are common activities carried out at Head Office like purchase, inventory management, finance, personnel, R & D, Quality Assurance, security etc. These activities sometimes, are centralized at one place i.e. Head Office for business convenience and scale of economy and booked as head office expenses along with other activities like secretarial, project, treasury, investment, trading, etc. They do not form part of the Administration overheads. For example: Industrial relation Department; Material management; Operation/production planning Department; Human Resources, System Design & Development Set Up and the like are production related activities. Nomenclature or place where the activity takes place is not relevant. In such a situation, activities at Head Office/Corporate level are to be clearly demarcated and segregated so as to distinguish activities that contribute clearly and directly to production activities from general management and administration activities. It is necessary to properly analyze the expenses of such activities of head office and allocate these to plants/products on rational basis.

Question 2:

As an cost auditor of a company, how would you deals with the following issues –

(i) Valuation of Stock of work-in-progress and finished goods;

(ii) Treatment of Joint Products and By-Products;

(iii) Treatment of Scrap and Waste.

Answer:

(i) Valuation of Stock of work-in-progress and finished goods

Stock of work-in-progress shall be valued at cost on the basis of stages of completion as per the cost accounting principles. Similarly, stock of finished goods shall be valued at cost. Opening and closing stock of work-in-progress shall be adjusted for calculation of cost of goods produced and similarly opening and closing stock of finished goods shall be adjusted for calculation of goods dispatched.

For determining the cost of production for captive consumption, adjustment for opening and closing stock of work-in-progress shall be made. The valuation of opening stock and closing stock of WIP is valued at cost on the basis of stages of completion. Similarly for calculation of cost of finished goods dispatched, adjustment for opening and closing stock of finished goods, if any, is to be made. In case the cost of a shorter period is to be determined, where the figures of opening and closing stock are not readily available, the adjustment of figures of opening and closing stock may be ignored.

Adjustment of opening and closing stock of WIP/finished goods will arise only when the cost of production is to be determined for historical cost and due consideration shall be given for above adjustment in determining the cost of production. However, if cost of production is to be determined for a future period, it will be based on projected cost and projected capacity utilisation. In such cases, adjustment of opening and closing WIP/finished goods and valuation thereof does not arise.

(ii) Treatment of Joint Products and By-Products

In case joint products are produced, joint costs are allocated between the products on a rational and consistent basis. In case by-products are produced, the net realisable value of by-products is credited to the cost of production of the main product.

For allocation of joint cost to joint products, the sales values of products at the split off point i.e. when the products become separately identifiable may be the basis. It may be allocated based on a measure of the number of units, weight or volume. Some other basis may be adopted. For example, in case of petroleum products, each product is assigned certain value based on its certain properties, may be calorific value and these values become the basis of apportionment of joint cost among petroleum products.

The joint cost shall be allocated to the cost of production of Joint Products as per the generally accepted cost accounting principles.

By-product:

It is difficult to determine the cost of by-product. By products are sold:

(1) Either in original form without further processing; or

(2) or processed in order to be saleable. In such case, the main product is credited with the sale realization (gross/net) as the case may be. In other words expenses incurred to bring by-product to marketable conditions shall be adjusted from the sale of by product and net realizable value of by-product shall be credited to cost of production of main product.

In case sale realization is not available, credit to main product at substitute value of by product may be given.

(iii) Treatment of Scrap and Waste

The production process may generate scrap or waste. Realized or realizable value of scrap or waste shall be credited to the cost of production.

In case, scrap or waste does not have ready market and it is used for reprocessing, the scrap or waste value shall be taken at a rate of input cost depending upon the stage at which such scrap or waste is recycled. The expenses incurred for making the scrap suitable for reprocessing shall be deducted from value of scrap or waste.

Question 3:

(a) Whether finance costs incurred in connection with the acquisition of materials shall form part of material cost?

Answer:

Finance costs incurred in connection with the acquisition of materials shall not form part of material cost.

Finance costs are interest and the like, on borrowed funds. Finance costs are excluded from cost of material. The letter of credit charges are for credit risk or a transaction risk (demand bill) and are part of bank charges which form part of administrative overheads.

Sometimes goods are kept in bonded warehouse and clearance of goods is delayed. This may happen due to any financial stringency delaying the payment to the bank. Such payments of storage are to be excluded from cost of material calculation and are dealt with in the financial accounts.

(b) Raj & Co. furnish the following expenditure incurred by them and want you to find the assessable value for the purpose of paying excise duty on captive consumption. Determine the cost of production in terms of rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 and as per CAS-4 (cost accounting standard) (i) Direct material cost per unit inclusive of excise duty at 10% - ₹ 1,320 (ii) Direct wages - ₹ 250 (iii) Other direct expenses - ₹ 100 (iv) Indirect materials - ₹ 75 (v) Factory Overheads - ₹ 200 (vi) Administrative overhead (25% relating to production capacity) ₹ 100 (vii) Selling and distribution expenses - ₹ 150 (viii) Quality Control - ₹ 25 (ix) Sale of scrap realized - ₹ 20 (x) Actual profit margin - 15%.

Solution:

Computation of Cost of Production (as per CAS-4)

Particulars	Amount (₹)
Direct Material (exclusive of Excise Duty) [1,320 x 100/112.36]	1,174.80
Direct Labour	250.00
Direct Expenses	100.00
Works Overhead [indirect material (75) plus Factory OHs (200)]	275.00
Quality Control Cost	25.00
Research & Development Cost	Nil
Administration Overheads (to the extent relates to production activity)	25.00
Less: Realizable Value of scrap	(20.00)
Cost of Production	1,829.80
Add: 10% as per Rule 8	183.00
Assessable Value	2,012.80

(c) Basic pay ₹5,00,000; Lease rent paid for accommodation provided to an employee ₹2,00,000, amount recovered from employee ₹40,000, Employer's Contribution to P.F. ₹75,000, Employee's Contribution to P.F. ₹75,000; Reimbursement of Medical expenses ₹67,000, Hospitalisation expenses of employee's family member borne by the employer ₹19,000, Festival Bonus ₹20,000, Festival Advance ₹30,000. Compute the Employee cost.

Solution:

Computation of Employee Cost

Particulars		**Amount (₹)**
	Basic Pay	5,00,000
Add	Net cost to employer towards lease rent paid for accommodation provided to an employee [= lease rent paid less amount recovered from employee] = [2,00,000 (-) 40,000]	1,60,000
Add	Employer's Contribution to PF	75,000
Add	Reimbursement of Medical Expenses	67,000
Add	Hospitalisation expenses of employee's family member paid by the employer	19,000
Add	Festival Bonus	20,000
	Employee Cost	**8,41,000**

Note:

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

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

Question 4:

(a) Trial Balance as on 31.3.2013 (relevant extracts only)

Particulars	**Amount (₹)**	**Particulars**	**Amount (₹)**
Materials consumed	25,00,000		
Salaries	15,00,000	Special Subsidy received from Government towards Employee salary	2,75,000
Employee Training Cost	2,00,000	Recoverable amount from Employee out of perquisites extended	35,000
Perquisites to Employees	4,50,000		
Contribution to Gratuity Fund	4,00,000		
Lease rent for accommodation provided to employees	3,00,000		
Festival Bonus	50,000		
Unamortised amount of Employee cost related to a discontinued operation	90,000		

Solution:

Computation of Employee Cost

	Particulars	**Amount (₹)**
	Salaries	15,00,000
Add	Net Cost of Perquisites to Employees = Cost of Perquisites (-) amount recoverable from employee = 4,50,000 (-) 35,000	4,15,000
Add	Lease rent paid for accommodation provided to employee	3,00,000
Add	Festival Bonus	50,000
Add	Contribution to Gratuity Fund	4,00,000
Less	Special subsidy received from Government towards employee salary	(2,75,000)

	Employee Cost	**23,90,000**

Note:

(i) Recoverable amount from employee is excluded from the cost of perquisites.

(ii) Employee training cost is not an employee cost. It is to be treated as an Overhead, hence, not included.

(iii) Special subsidy received is to be excluded, as it reduces the cost of the employer.

(iv) Unamortized amount of employee cost related to a discontinued operation is not an includible item of cost.

(b) What are the disqualifications of a Cost Auditor?

Answer:

Disqualifications of a Cost Auditor

The disqualifications of a person for being appointed or re-appointed for conducting the cost audit are detailed in sub-Sections (a), (b) and (c) Section 233 (5) of the Companies Act, 1956 detailed as under:

(a) The sub-Section (5)(a) provides that a person referred to in sub-Section (3) or sub-Section (4) of the Section 226 shall not be appointed or re-appointed for conducting the audit of the cost accounts of a company.

(b) The sub-Section 5(b) provides that a person appointed under Section 224 as an auditor of a company shall not be appointed or re-appointed for conducting the audit of the cost accounts of that company.

(c) The sub-Section (5)(c) provides that if a person, appointed for conducting the audit of cost accounts of a company, becomes after his appointment, to any of the disqualifications specified in clause 5(a) or 5(b) above, he shall on and from the date on which he becomes disqualified, shall cease to conduct the audit of the cost accounts of the company.

Section 226 of the Companies Act, 1956 provides for the qualifications and disqualifications of the auditors. Reading of sub-Section (3) of Section 226 implies that the following persons cannot be appointed or reappointed as cost auditor of a company –

(a) a body corporate;

(b) an officer or employee of the company;

(c) a person who is a partner, or who is in the employment, of an offi cer or employee of the company;

(d) a person who is indebted to the company for an amount exceeding one thousand rupees or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding one thousand rupees;

(e) a person holding any security of that company after a period of one year from the date of commencement of the Companies (Amendment) Act, 2000. (Explanation: "security" means an instrument which carries voting rights);

The sub-Section (4) of Section 226 provides that a person shall also not be qualified for appointment as auditor of a company if he is, by virtue of sub-Section (3), disqualified for appointment as auditor of any other body corporate which is that company's subsidiary or holding company or a subsidiary of that company's holding company, or would be so disqualified if the body corporate were a company. In other words, if a person is disqualified under any of the aforesaid classes from being appointed as an auditor of any company or body corporate, he cannot be appointed as auditor of its holding company, subsidiary or 'co-subsidiary'; and

A person, who is in full time employment elsewhere [Section 224 (1B)]. If an auditor becomes disqualified after his appointment, under any of the above provisions he shall be deemed to have vacated his office.

Question 5:

(i) State the power of a Cost Auditor of a Company?

(ii) State the provision relating to number of cost audit can do by a Cost Auditor for a financial year?

Answer:

(i) Powers of Cost Auditor

Section 233B (4) of the Companies Act, 1956 gives the cost auditor same powers as the financial auditor has under Section 227(1). In addition, Rule 6 of the Cost Audit Report Rules also requires the company and every officer thereof, including the persons referred to in sub-Section (6) of Section 209 of the Act to make available to the cost auditor, within 135 days from the close of the financial year of the company, such cost accounting records, cost statements, other books and documents, Annexure and Proforma 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. Section 233B(6) further provides that it shall be the duty of the company to give all facilities and assistance to the cost auditor so as to enable him to complete the audit and send the report within the prescribed time limit.

The powers of the cost auditor under sub-Section (1) of Section 227 are as under:

- Right to access at all times to the books and accounts and vouchers of the company, whether kept at the head office of the company or elsewhere.

- Entitled to require from the officers of the company such information and explanations as he may think necessary for the performance of his duties as an auditor.

(ii) Ceiling on Number of Cost Audits

The sub-Section (2) of Section 233B inter-alia provides that before the appointment of any auditor is made by the Board, a written certificate shall be obtained by the Board from the auditor proposed to be so appointed to the effect that the appointment, if made, will be in accordance with the provisions of sub-Section (1B) of Section 224.

Section 224(1)(B) provides that no company or its Board of directors shall appoint or re-appoint any person who is in full time employment elsewhere or firm as its auditor if such person or firm is, at the date of such appointment or re-appointment, holding appointment as auditor of the specified number of companies or more than the specified number of companies. The proviso to Section 224(1B) further provides that the provisions of this sub-Section shall not apply, on and after the commencement of the Companies (Amendment) Act, 2000, to a private company.

Explanation I to the Section 224 provides that for the purposes of sub-Sections (1B) and (1C), "specified numbers" means :

(a) in case of a person or firm holding appointment as auditor of a number of companies each of which has a paid-up share capital of less than rupees twenty-five lakhs, twenty such companies;

(b) in any other case, twenty companies, out of which not more than ten shall be companies each of which has a paid-up share capital of rupees twenty-five lakhs or more.

Explanation II to the Section 224 provides that in computing the specified number, the number of companies in respect of which or any part of which any person or firm has been appointed as an auditor, whether singly or in combination with any other person or firm shall be taken into account.

In view of aforesaid provisions, the ceilings on the number of cost audits can be clarified as under:

(a) In the case of firm of cost accountants: Twenty companies for each such partner of the firm who is not in full time employment. However, not more than ten such companies should have a paid up share capital of Rs. 25 lakhs or more;

(b) In the case of an individual cost accountant, who is not in full time employment: Twenty companies, out of which not more than ten should have a paid-up share capital of Rs. 25 lakhs or more.

It can be seen from above that Section 224(1B) and Explanation I to Section 224 refers to the ceilings for the number of companies and not to the number of cost audit orders or products. Therefore, if more than one products of a particular company are covered under cost audit for the same year, a cost auditor should count their number as one company only, since the audits for all the products relate to the same company despite the fact that separate cost audit orders have been issued with respect to each such product. Similarly, if that company appoints different cost auditors for different products, each auditor shall count the company as one company for counting their individual quota for number of audits.

It should be noted that the Companies (Amendment) Act, 2000 has inserted a provision (Explanation II) to Section 224, whereby the provisions of sub-section 1-B shall not apply to a Private Company.

It means that for computing the limit on number of companies for audit, Private Companies should not be counted.

Question 6:

(i) State the needs & elements of planning in a Cost Audit?

(ii) Discuss the essential features of a cost accounting system.

Answer:

(i) Planning and Structuring the Cost Audit

Need for Planning an Audit:

The Cost Auditor should always plan to conduct an effective cost audit in an efficient and timely manner. This is very necessary to attain objectives of the cost audit. Audit plan for new client will be generally more detailed than in case of a repeat audit. In case of new audit, the cost auditor has to collect all information about the company like nature of business, organization structure, key personnel, accounting system etc. Similarly, he has to also collect information about other peers in the industry, nature of problems etc. The details required shall be much less in case of a repeat audit. The proper planning helps in:

(a) appropriate attention to all the areas for comprehensive audit;

(b) identification of key areas needing more attention;

(c) timely completion of work;

(d) optimum utilization of assistants;

(e) no overlapping and proper co-ordination between the work done by different assistants, other auditors and experts.

Elements of Planning:

Planning of cost audit involves:

(a) Familiarization about the company and applicable cost accounting record rules;

(b) Collection of all relevant information;

(c) Evaluation of internal control procedures and the system;

(d) Preparation of appropriate cost audit programme; and

(e) Audit of working papers and cost sheets.

Cost Built up, Cost Audit Report and Compliance Report.

(ii) Essentials

If a cost accounting system is to effectively serve the various purposes set forth e, it must incorporate in itself the following essential features.

a) Recognition of Diverse Behaviour of Cost Components

Cost of a product, a process or function comprises of several components, such as raw materials, direct operating labour, electricity, rent etc. It is now well recognized that all these do not behave in similar fashion with respect to volume of output and/or time. Obviously, larger quantities of raw materials are necessary to produce larger volumes of a finished product. However, supervision and rent might remain the same as long as the increased production can be handled with existing facilities.

b) Fixation of Control Responsibility for various Costs

A cost accounting system must recognize that control of costs be best exercised at the source. This implies that costs can be appropriately controlled by persons which in fact incur or have authority to incur them. Since the authority to incur various costs is not vested in one individual or place in the organization but is delegated to several individuals and functional areas throughout the organization, it is obvious that the control responsibility for various costs must likewise fall on several persons or places in the organization. A cost accounting system must, therefore, appropriately assign responsibility for different types of costs and must provide for classification, accumulation and reporting of cost information in accordance with control responsibility which in turn will aid the management in exercising effective control.

c) Provision of Yardstick for Performance Management

From control angle, the knowledge of actual cost of a product, a process, an event or an activity is not enough in itself. Simultaneously, one would like to know just how much it should have been in normal circumstances, and further would like to compare the actual with what "should have been". In other words, one would desire to measure one's own cost performance or the cost performance of those responsible to him. The measurement of cost performance helps to reveal and direct attention to the inefficient areas.

Question 7:

(i) State the composition of the Cost Audit and Assurance Standards Board.

(ii) What are the objectives and functions of the Cost Audit and Assurance Standards?

Answer:

(i) Composition of the CAASB

The composition of the CAASB is fairly broad based to ensure participation of all interest groups in the standard setting process. Apart from six members of the Council of the Institute nominated in the CAASB, the following are represented on the CAASB:

1. Head, Cost Audit Branch, Ministry of Corporate Affairs, Government of India
2. One member to be nominated by the Comptroller & Auditor General of India
3. Two members to be nominated by the Regulatory bodies
4. Two eminent members of the Institute in Public Practice
5. Two members representing Industry / Industry Associations / Professional Institutes

Members mentioned at (4) & (5) above are decided in consultation with the President. In addition, the President is authorised to include a maximum of two eminent persons having relevant knowledge and expertise not falling under the categories mentioned above.

The Chairman of the CAASB is nominated by the Council of the Institute.

The quorum of the CAASB is five members.

The terms and period of appointment of the chairman and other members, excluding the nominee members, is decided by the Council of the Institute. This is, however, restricted to the term of the Council.

(ii) Objectives and Functions

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

Board:

a) To identify areas in which Standards on Quality Control, Assignment Standards, Standards on Auditing and Standards on Related Services need to be developed.
b) To develop Standards on Quality Control, Assignment Standards, Standards on Auditing and Standards on Related Services so that they may be issued under the authority of the Council of the Institute.
c) To develop Guidance Notes on issues arising out of any Standard or on auditing issues pertaining to any specific industry or on generic issues so that they may be issued under the authority of the Council of the Institute.
d) To formulate and issue Technical Guides, Practice Manuals and other Papers under its own authority for guidance of Cost Accountants in the cases felt appropriate by the Board.

e) To review the existing Standards, Guidance Notes, Technical Guides, Practice Manuals and other Papers to assess their relevance in the changed conditions and to undertake their revision, if necessary.

f) To provide Interpretations or formulate General Clarifications, where necessary, on issues arising from the Standards.

Question 8:

(i) Explain the procedures for issue of Cost Accounting Standard (CAS).

(ii) Explain the procedures for issue of Guidance Notes.

Answer:

(i) Procedure for issuing the Standards

The following procedure is adopted for formulating and issuing the Standards:

I. Proposals to develop new Standards or revise the existing ones, are identified by the CAASB based on the national and international developments, inputs from members of the Council of the Institute, CAASB members, members of other committees of the Institute, members of the Institute and/or recommendations received from the Government, regulators, industry associations, or other interest groups.

II. CAASB determines the priorities of various proposals on hand for the development of the Standards.

III. CAASB constitutes separate Task Force or Study Group to develop preliminary draft of each Standard based on appropriate research and consultation with all interest groups, other professionals and regulators. The Task Force / Study Group also consider relevant pronouncements issued by the IFAC, if any.

IV. The preliminary draft Standard prepared by the Task Force / Study Group is considered by the CAASB with inputs from the Technical Directorate. After a para by para discussion, CAASB either clears the draft Standard, with or without any modifications or refers the same to the Task Force / Study Group for revision based on the deliberations of the CAASB.

V. In case the preliminary draft Standard is re-drafted by the Task Force / Study Group, the revised draft is again considered by the CAASB with inputs from the Technical Directorate. Based on the discussions held, CAASB clears the draft Standard. This is then issued as an Exposure Draft under the authority of the CAASB.

VI. Each Standard generally follows the following structure. In case of deviation, suitable explanation is provided by the Task Force / Study Group preparing the Standard.

1. Introduction
2. Objectives of issuing the standard
3. Scope of the standard
4. Definitions and explanations of the terms used in the standard
5. Requirements
6. Application and other explanatory material
7. Effective date

VII. Exposure draft of the Standard is hosted on the website of the Institute and published in Management Accountant journal for comments of stakeholders and public at large Copies of the Exposure Draft are sent to the members of the Central Council, Past Presidents, members of the Regional Councils & Chapters and circulated among other bodies for their comments. Exposure Draft is also sent to the following bodies:

i. Ministry of Corporate Affairs, Government of India

ii. Comptroller and Auditor General of India

iii. Reserve Bank of India

iv. Central Board of Direct Taxes

v. Central Board of Excise and Customs

vi. Securities and Exchange Board of India

vii. Institute of Chartered Accountants of India

viii. Institute of Company Secretaries of India

ix. Industry Associations such as CII, FICCI, ASSOCHAM and PHDCCI

x. Concerned regulators or any other body considered relevant by the CAASB keeping in view the nature and requirements of the Standard.

VIII. To allow adequate time for due consideration and comment from all interested parties, exposure period is of minimum 45 days or higher as decided by the CAASB.

IX. The comments and suggestions received within the exposure draft period are read and considered by the CAASB. Outcome of each comment / suggestion is recorded in the minutes of the relevant CAASB meeting.

X. After taking into consideration the comments received, the draft of the proposed Standard is finalised by the CAASB and submitted to the Council of the Institute for its consideration and approval.

XI. The Council of the Institute considers the final draft of the proposed Standard, and if found necessary, modifies the same in consultation with the CAASB. The concerned Standard is then issued under the authority of the Council of the Institute.

XII. The effective date of implementation of the Standard is decided by the Council of the Institute in consultation with the CAASB. No Standard will have retrospective application unless otherwise stated.

(ii) Procedure for issuing Guidance Notes

The following procedure is adopted for formulating and issuing the Guidance Notes:

I. CAASB identifies the issues on which Guidance Notes need to be formulated. CAASB also determines the priorities of various proposals on hand for commencement.

II. CAASB constitutes separate Guidance Notes Committee (GNC) to develop draft of each Guidance Note. Each Committee has a minimum of three members, of which at least one is a member of the CAASB and others with backgrounds as preparers of cost statements, auditors and regulators. One of the members of CAASB is the Chairman of the said Committee. He is authorised to co-opt maximum two members with the consent of the Chairman, CAASB.

III. The draft Guidance Note prepared by the GNC is considered by the CAASB with inputs from the Technical Directorate. After a para by para discussion, CAASB either clears the draft Guidance Note, with or without any modifications or refers the same to the GNC for revision based on the deliberations of the CAASB.

IV. In case the draft Guidance Note is re-drafted by the GNC, the revised draft is again considered by the CAASB with inputs from the Technical Directorate. Based on the discussions held, CAASB clears the draft Guidance Note. This is then issued as an Exposure Draft under the authority of the CAASB.

V. Exposure draft of the Guidance Note is hosted on the website of the Institute for comments of stakeholders and public at large. Copies of the Exposure Draft are sent to the members of the Central Council, Past Presidents, members of the Regional Councils & Chapters and circulated among other bodies for their comments.

VI. To allow adequate time for due consideration and comment from all interested parties, exposure period is of minimum 45 days or higher as decided by the CAASB.

VII. The comments and suggestions received within the exposure draft period are read and considered by the CAASB. Outcome of each comment / suggestion is recorded in the minutes of the relevant CAASB meeting.

VIII. After taking into consideration the comments received, the draft of the proposed Guidance Note is finalised by the CAASB and submitted to the Council of the Institute for its consideration and approval.

IX. The Council of the Institute considers the final draft of the proposed Guidance Note, and if found necessary, modifies the same in consultation with the CAASB. The concerned Guidance Note is then issued under the authority of the Council of the Institute.

X. The Guidance Note of a Standard is explanatory to the corresponding Standard and will not override the same.

Question 9:

(i) Why professional skepticism is necessary during audit period?

(ii) What are the audit risks should be considered by an auditor during in an audit?

Answer:

Professional skepticism: An attitude of professional skepticism means the cost auditor makes a critical assessment, with a questioning mind, of the validity of audit evidence obtained and be alert to audit evidence that contradicts or brings into question the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. An attitude of professionalism is necessary throughout the cost audit process for the auditor to reduce the risk of overlooking unusual circumstances, of over generalizing when drawing conclusions from cost audit observations, and of using faulty assumptions in determining the nature, timing and extent of the cost audit procedures and evaluating the results thereof. When making inquiries and performing other cost audit procedures, the cost auditor is not satisfied with less-than-persuasive audit evidence based on a belief that management and those charged with governance are honest and have integrity. Accordingly, representations from management are not a substitute for obtaining sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the cost auditor's opinion.

(i) A cost auditor conducting an audit in accordance with CAAS AND GACAAP obtains reasonable assurance that the Cost Statements taken as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a concept relating to the accumulation of the audit evidence necessary for the auditor to conclude that there are no material misstatements in the Cost Statements taken as a whole. Reasonable assurance relates to the whole audit process.

A cost auditor cannot obtain absolute assurance because there are inherent limitations in an audit that affect the cost auditor's ability to detect material misstatements. These limitations result from factors such as the following:

- The use of sample testing.
- The inherent limitations of internal control (for example, the possibility of management override or collusion).
- The fact that most audit evidence is persuasive rather than conclusive.

Also, the work undertaken by the cost auditor to form an audit opinion is permeated by judgment, in particular regarding:

a) The gathering of audit evidence, for example, in deciding the nature, timing and extent of audit procedures; and

b) The drawing of conclusions based on the audit evidence gathered, for example, assessing the reasonableness of the estimates made by management in preparing the Cost Statements.

(ii) Further, other limitations may affect the persuasiveness of audit evidence available to draw conclusions on particular assertions. (for example, transactions between related parties). In these cases certain CAAS AND GACAAPs identify specified audit procedures which will, because of the nature of the particular assertions, provide sufficient appropriate audit evidence in the absence of:

a) Unusual circumstances which increase the risk of material misstatement beyond that which would ordinarily be expected; or

b) Any indication that a material misstatement has occurred.

Accordingly, because of the factors described above, an audit is not a guarantee that the Cost Statements are free from material misstatement, because absolute assurance is not attainable. Further, an audit opinion does not assure the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity.

(ii) Audit Risk and Materiality: Entities pursue strategies to achieve their objectives, and depending on the nature of their operations and industry, the regulatory environment in which they operate, and their size and complexity, they face a variety of business risks. Management is responsible for identifying such risks and responding to them. However, not all risks relate to the preparation of the Cost Statements the auditor is ultimately concerned only with risks that may affect the cost statements.

(a) The cost auditor obtains and evaluates audit evidence to obtain reasonable assurance about whether the Cost Statements give a true and fair view or in accordance with the applicable cost reporting framework. The concept of reasonable assurance acknowledges that there is a risk the audit opinion is inappropriate. The risk that the cost auditor expresses an inappropriate audit opinion when the Cost Statements are materially misstated is known as "audit risk." The cost auditor reduces audit risk by designing and performing audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base an audit opinion. Reasonable assurance is obtained when the auditor has reduced audit risk to an acceptably low level.

(b) Audit risk is a function of the risk of material misstatement of the cost statements (or simply, the "risk of material misstatement") (i.e., the risk that the Cost Statements are materially misstated prior to audit) and the risk that the auditor will not detect such misstatement ("detection risk"). The cost auditor performs audit procedures to assess the risk of material misstatement and seeks to limit detection risk by performing further audit procedures based on that assessment. The audit process involves the exercise of professional judgment in designing the audit approach, through focusing on what can go wrong (i.e., what are the potential misstatements that may arise) at the assertion level and performing audit procedures in response to the assessed risks in order to obtain sufficient appropriate audit evidence.

(c) The cost auditor is concerned with material misstatements, and is not responsible for the detection of misstatements that are not material to the Cost Statements taken as a whole. The cost auditor considers whether the effect of identified uncorrected misstatements, both individually and in the aggregate, is material to the Cost Statements taken as a whole. Materiality and audit risk are related

In order to design audit procedures to determine whether there are misstatements that are material to the cost statements taken as a whole, the cost auditor considers the risk of material misstatement at two levels:

- the overall cost statement level and
- in relation to cost heads, items of cost and disclosures and the related assertions.

(d) The cost auditor considers the risk of material misstatement at the overall cost statement level, which refers to risks of material misstatement that relate pervasively to the Cost Statements as a whole and potentially affect many assertions. Risks of this nature often relate to the entity's control environment (although these risks may also relate to other factors, such as declining economic conditions), and are not necessarily risks identifiable with specific assertions at the cost heads, items of cost or disclosure level. Rather, this overall risk represents circumstances that increase the risk that there could be material misstatements in any number of different assertions, for example, through management override of internal control. Such risks may be especially relevant to the cost auditor's consideration of the risk of material misstatement arising from fraud. The auditor's response to the assessed risk of material misstatement at the overall cost statement level includes consideration of the knowledge, skill, and ability of personnel assigned significant engagement responsibilities, including whether to involve experts; the appropriate levels of supervision;

(e) The cost auditor also considers the risk of material misstatement at the cost heads, items of cost and disclosure level because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level. The cost auditor seeks to obtain sufficient appropriate audit evidence at the cost heads, items of cost, and disclosure level in such a way that enables the auditor, at the completion of the audit, to express opinion on the Cost Statements taken as a whole at an acceptably low level of cost audit risk. Auditors use various approaches to accomplish that objective. The discussion in the following paragraphs provides an explanation of the components of audit risk.

Question 10:

What are the mechanisms which is suggested for performance analysis?

Answer:

Suggested mechanism for performance analysis

(i) After analyzing the activities within each process, we come to the operational part of Form III of the Companies (Cost Audit Report) Rules 2011. We give below the suggested mechanism for performance analysis as follows:

(ii) In the above paragraphs, we discussed how the strategies are formulated, how they are implemented through the processes and now we come to assess the actual performance. Performance measures tell managers something important about the company's products, services, and the processes. Effective performance measures can let us:

- Monitor performance to judge how well the company is doing,
- Know if company is meeting its own set goals and if the customers are satisfied,
- Take action to affect performance or improve efficiency if improvements are necessary.

So we need to identify appropriate Performance measures so that the analyst is provided data and information necessary to make informed decisions. Performance measures provide a snapshot of current performance capabilities and track whether actual performance is getting better, staying the same, or getting worse over time. Machine hour rate is a performance measure which provides us inputs for various decisions. Capital expenditures tell about the investment of funds; we communicate the return on that investment through performance measures.

(iii) Keep the focus of the chosen performance measure on things that matter most, such as:

- Are we accomplishing our mission to analyze the performance?
- Are the processes achieving strategic goals and objectives?
- Are the customers satisfied?
- Are various processes being managed by the company properly?
- Are the output and outcomes observed result in the company being cost-efficient as the industry leader?

Narrowing the list of measures requires judgment and knowledge about the organization's systems and customers. Keep in mind that the audience who receives the information set the standard for what is relevant and important. Typically, internal audiences are interested in process-level measures and production outputs. Surveys may be measurement tools of last resort for qualitative subjects that defy attempts to measure them quantitatively, such as customer satisfaction. Survey scores can be useful to internal audiences, but usually mean little to external audiences. External audiences involved in budget and policy development are more interested in efficiency and outcome (results) measures. Because ultimate outcomes are often influenced by many factors besides a company's work, the most meaningful measures for judging effectiveness may be immediate outcomes.

(iv) Try to avoid common mistakes in writing about selected performance measures:

- Should not include explanations of why the measure is important or how the data is collected. Those comments belong to in operational details, footnotes, or unpublished notes.
- Avoid jargon and acronyms in performance measure titles, so readers who are not subject matter experts can understand what is being measured.

- Don't word performance measures as objectives. Objective statements include words such as "increase" or "decrease," which imply change. Objective statements are not performance measures, although performance measures can tell us whether we are meeting our objectives.

Question 11:

(i) Discuss the "Terms of Internal Audit Engagement" as per Standard on Internal Audit 8.

(ii) What are the objectives of environment audit in India?

Answer:

(i) Terms of Internal Audit Engagement (SIA 8):

i. Internal auditor and the auditee should agree on the terms of engagement before commencement. Terms should be approved by the Board of Directors or a relevant Committee thereof such as the Audit Committee or such other person(s) as may be authorised by the Board in this regard.

ii. It should contain a statement in respect of the scope of internal audit engagement.

iii. It should clearly mention that internal auditor would not be involved in the preparation of auditee's financial statements. It should also be made clear that the internal audit would not result in the expression of an opinion or any other form of assurance on the auditee's financial statements or any part thereof.

iv. The terms of engagement should clearly mention the responsibility of the auditee vis-a-vis the internal auditor.

v. It should provide the internal auditor with requisite authority, including unrestricted access to all departments, records, property and personnel and authority to call for information from concerned personnel in the organization.

vi. The internal auditor should have full authority on his technologies and other properties like hardware and audit tools he may use in course of performing internal audit.

vii. It should be clear that the ownership of working papers rests with internal auditor and not the auditee.

viii. The engagement letter should contain a condition that the report of internal auditor should not be distributed or circulated by the auditee or the internal auditor to any party other than that mutually agreed between the internal auditor and auditee unless there is a statutory or a regulatory requirement to do so.

ix. There should be a clear understanding among internal auditor and auditee as to the basis on which the internal auditor would be compensated, including any out of pocket expense, taxes etc, for the services performed by him.

x. It should contain a statement that the internal audit engagement would be carried out in accordance with the professional Standards applicable to such engagement as on the date of audit.

(ii) The objectives of an environment audit are –

(a) to ensure cost effectiveness compliance with the statutes and company policies
(b) cost savings from improved practices
(c) to prepare data-base relating to pollution potential of all facilities

(d) to make a social cost-benefi t analysis
(e) to develop social reputation, confi dence of customers
(f) to develop overall awareness, identifying problems and areas of risk
(g) to encourage the use of low waste technologies and prudent use of resources and to identify
(h) potential hazards and risks.

Question 12:

(i) What are the evidences necessary to obtain by an internal auditor of the company?

(ii) In an internal audit, it is necessary to obtain the knowledge of the entity and its environment. Comments

Answer:

Internal Audit Evidence (SIA10):

i. To obtain sufficient appropriate evidence to enable him to draw reasonable conclusions therefrom on which to base his opinion or findings.

ii. Scope of an internal audit is much broader in comparison to that of statutory audit. The depth of coverage of internal audit, being a management function, would also be much wider. An internal audit function normally is spread beyond checking of financial transactions and is expected to cover comments on internal control systems, risk management, propriety aspect of transactions.

iii. To evaluate sufficiency of appropriate audit evidence before conclusions therefrom. The internal audit evidence should enable internal auditor to form a opinion on the scope of the terms of engagement.

iv. The reliability of internal audit evidence depends on its source – internal or external and on its type.

v. When internal audit evidence obtained from one source is inconsistent with that obtained from another, or the internal auditor has doubts over the reliability of information to be used as internal audit evidence, the internal auditor shall determine what modifications to or additional audit procedures are necessary to resolve the matter.

vi. Various methods for obtaining audit evidence include inspection, observation, inquiry and confirmation, computation and analytical review.

(ii) As per Standard on Internal Audit 15, it is necessary to obtain the knowledge of the Entity and its Environment which is as follows:

i. To obtain knowledge of the economy, entity's business and its operating environment, including its regulatory environment and the industry in which it operates, sufficient to enable him to review the key risks and entity–wide processes, systems, procedures and controls. To identify sufficient, appropriate, reliable and useful information to achieve the objectives of the engagement.

ii. Prior to accepting an engagement, the internal auditor should obtain a preliminary knowledge of the industry and of the nature of ownership, management, regulatory environment and operations of the entity subjected to internal audit, and should consider whether a level of knowledge of the entity's business adequate to perform the internal audit can be obtained.

iii. Following the acceptance of the engagement, further and more detailed information should be obtained. To the extent practicable, the internal auditor should obtain the required knowledge at the commencement of the engagement. As the internal audit progresses, that information should be assessed, enhanced, updated, refined and validated as the internal auditor and the engagement team obtain more knowledge about the entity's business.

iv. In case of continuing engagements, internal auditor should update and re– evaluate information gathered previously, including information in the prior year's working papers. The internal auditor should also perform procedures designed to identify significant changes that have taken place in the operations, control environment, technology and strategic processes since the last internal audit.

v. To obtain sufficient, appropriate information about the entity. An understanding of business risks facing the entity increases the likelihood of identifying risks of material misstatement in the information subject to internal audit.

vi. Knowledge of the entity's business is a frame of reference within which the internal auditor exercises professional judgment in reviewing the processes, controls and risk management procedures of the entity.

vii. To ensure that the internal audit engagement team assigned to an internal audit engagement obtains sufficient knowledge of the business to enable them to carry out internal audit work delegated to them. The internal auditor should also ensure that the audit team appreciates and understands the need tobe alert for additional information and the need to share that information with the internal auditor and other members of internal audit team.

viii. To make effective use of knowledge about the business, internal auditor should consider how this knowledge acquired, affects his review of internal controls and systems taken as a whole and whether his overall entity–wide assessment of systems, procedures, controls and risk management principles are consistent with his knowledge of the entity's business.

ix. The information and knowledge obtained by the internal auditor on the entity and its environment should be adequately documented in the engagement working papers.

Question 13:

(i) What are the points should be considered by the management auditor of the company in the evaluation and measurement of capacity utilization?

(ii) What are the scope and Usefulness of Management Audit?

Answer:

The management auditor shall consider the following points in the evaluation and measurement of capacity utilization –

1. Method of measuring base machine capacity.
2. Clear guidelines should be available regarding assessment of capacity. Technical terminology like licensed capacity, installed capacity, rated capacity etc. should be properly defined.
3. In some industries capacity is influenced by a number of factors and determining the single base figures requires adjustment of various variables such as volume of vessels, yield of product, recovery factor, cycle time etc.
4. Whether the system provides for comparative studies such as :

(i) Rated output and actual output per unit of time.

(ii) Normal output and actual output per unit of time.

5. Determine whether the capacity utilization report is being complied by a person not responsible for production.

6. Whether capacity measurement is based on "capital output ratio" or sundry other factors.

$$\text{Estimation of Capacity} = \frac{\text{Real Fixed Capital}}{\text{Minimum Capital Output Ratio}*}$$

* Capacity/ Real Output

$$\text{Capacity Utilization} = \frac{\text{Real Output}}{\text{Minimum Capital Output Ratio}} \times 100$$

(ii) Scope and Usefulness of Management Audit

The scope of management audit is decided by each organisation on its own needs. It has no limitations. It generally extends over all the resources deployed and commercial activities of the organisation including Directors and their functions.

— Managers, supervisors and their functions.

— Organizational structure.

— Equipment and facilities, and their utilization

— Methods and systems.

— Security of information.

— Resources utilization – their adequacy and efficiency.

— Planning and control etc.

The scope of management audit extends over all the functions of an organisation viz. management, personnel, administration, material administration, marketing, finance, etc. wherever the effectiveness of management needs to be examined.

Accordingly, the scope of management audit may include –

(i) The suitability, practicability and present compliance or otherwise of the organisation with its desired objectives and aims.

(ii) The current image of the organisation among customers, general public within its own particular industrial or commercial field.

(iii) Efficient utilization of resources of the organisation.

(iv) The rate of return of investors' capital – whether poor, adequate or above average.

(v) Relationship of the business with its own shareholders and investing public in general.

(vi) Employee relation.

(vii) The aims and effectiveness of management at its various levels such as top level, middle level, and operational level.

(viii) Financial policies and control relating to production, sales and distribution and in other functions of the organization.

An organization is accountable not only to its internal owners like shareholders but also socially accountable to creditors, Government, tax payers and consumers. Management audit extends to examination of accountability between the management and others at large. Audit mechanism ensures this accountability. Since the right to exercise control lies entirely with different set of people away from the owners, the examination of accountability and ensuring shareholders' and other participants' welfare becomes important. This is based on "Agency Theory" put forward by Jenson and Meckling.

The implications of separation of ownership and control were first analysed in depth by Berie & Menes in their study of development of Corporate Business in the USA. They observed that economic power was becoming increasingly concentrated in small number of people in large corporations and that within the corporation itself the right to exercise control which in law was vested in the hands of dispersed absentee shareholders, was effectively being usurped by entrenched management. Berie & Menes do not however, envisage transfer of power per se but lay emphasis on the initial conflict between the objectives of shareholders and managers. In this process the certification by an independent auditor gains importance.

Accountability and appropriate means for enforcing it is the main criteria of audit, particularly management audit. The process of accountability includes following elements:

(i) Description of the organisation and its participants.

(ii) Identification of objectives and the provision of relevant information to those objectives.

(iii) Ability of action on the part of the participants.

The value of auditing can be only judged by its ability to promote accountability of an organisation through their participants. The process of accountability is concerned with the needs of the participants of an organisation to determine the extent to which the behaviour of the organization conforms with their expectations. The monitoring mechanism should have sufficient variety to provide appropriate information to enable the participants to attempt the affect the behaviour of the organization.

Question 14:

(i) What are the uses of Management Audit?

(ii) What are the techniques and procedures for Management Audit?

Answer:

(i) Uses of Management Audit

(1) Management audit is useful in synthesizing, accounting, economic and other data required by management in constructing basic policy framework.

(2) Management audit assists in establishing, reviewing and improving the planning system.

(3) Management audit makes substantial contribution to system of goal setting in the organization.

(4) Management audit ensures that the management is getting the adequate information for correct decisions.

(5) Management audit ensures that the management properly uses the information that it is getting.

(6) Management audit aids in the design and maintenance of adequate authority structure.

(7) It helps in the improvement information system to expedite flow of information among responsibility centres.

(8) It substantially contributes for improvement of entire communication system.

(9) It helps management in pinpointing key functions or operations in the profit-making process.

(10) It helps management in establishing better criterion for measuring results.

(11) It helps management to avoid wasteful, unnecessary and extravagant use of resources.

(ii) Management Audit – Techniques and Procedures

(a) **Management auditing procedure:**

Audit procedures should be tailored to the specific needs of each situation examined. The general approach in a management audit may be outlined as follows :-

1. Make a preliminary survey of the activity under audit to obtain necessary background and other working information for use in conducting the audit.
2. Study the basic charter or assignment of responsibility of the activity under audit (applicable laws and related legislative history in the case of a government activity) to ascertain the authorized purposes and related authorities of the activity and any applicable restrictions or limitations.
3. Review pertinent parts of the system of management control by studying the policies established to govern the activities under audit, testing the effectiveness of specific operating and administrative procedures and practices followed, and fully exploring all significant weaknesses encountered.
4. Report on the findings of the audit work performed to those responsible for receiving or acting them together with the recommendations for improvement.

Techniques by which the auditor can identify problems areas warranting detailed examination and source of his information are as follows:

(i) Identification of possible control weakness by survey

During the preliminary survey work though which practical working information is obtained on how the activity is supposed to function and on how the activity is supposed to function and on how control procedures are supposed to work, key features or aspects can usually be identified which appear to be difficult to control effectively or to be susceptible to abuse. In a purchasing organisation, for example, the key points in the purchasing process may be –

a. the determination made of the quantities and the quality of materials to be purchased.

b. The procedure followed in obtaining the best prices, and

c. The methods for determining whether the correct quantities and quality are actually received.

If, in relation to the total purchasing operation, the auditor concludes that these processes are the most critical from the standpoint of the need for good performance, he would be justified in concentrating his testing work on them.

(ii) Review of management reports

The auditor's review of internal reports which the management itself regularly uses to obtain information on progress, status, or accomplishment of work can be valuable sources of information on possible problem areas suggesting audit attention.

(iii) Review of internal audit or inspection reports.

These report can also be a valuable source of information on problem areas. Of particular interest to the management auditor are those reports which bring to light significant findings on which the management has taken no action. Inquiry into the reasons and justification for inaction in such cases should be made, since these circumstances could throw light on weaknesses in management system that have not previously been referred to the management for resolution.

(iv) Physical inspection

Physical inspections of the organisation's activities and resources can be a useful way of identifying possible inefficiencies. Examples are apparently excess accumulations of material, idle or little used equipments, employee idleness, rejections of product by inspectors (or customers), executive rework operations, or disposal of apparently useful materials or equipment.

(v) Test examination of transactions

A very useful way to obtain a practical insight into the efficacy of procedures is to pursue a number of transactions pertaining to the organisation's operations from initiation to final disposition. This kind of testing will provide the auditor with valuable information on the organisation's business is actually transacted, on the usefulness (or pertinence) of prescribed procedure, on the capabilities of personnel involved in the various operating phases, and on possible weaknesses in procedures or practices which could represent an unnecessary drain on the organisation's resources (i.e. ineffective or inefficient performance)

(vi) Discussions with the officials and employees

The management auditor can obtain valuable information on problem areas warranting audit attention through discussions with responsible officials in the organisation and other employees concerned. The degree of success in obtaining useful information in this way is, in large part, dependent on the auditor's reputation for independent and constructive inquiry. If he is regarded with fear because of overly critical reporting in the past, this source of information may not be productive.

Testing procedures and practices

Testing procedures and practices first requires some preliminary review work to obtain information on how they actually work and an insight into their effectiveness and usefulness. On the basis of such review, specific matters may be identified as problem areas on weaknesses needing further probing. The general factors to be considered by the auditor in his preliminary review work on management controls are :

— Whether the policies of the organization comply with its basic charter or grant of authority.

— Whether the system of procedures and management controls is designed to carry out those policies and result in activities being conducted as desired by the top management, and in an efficient and economical manner.

— Whether the system of management controls provides adequate control over the organisation's resources, revenues, costs and expenditures.

Specific factors which may well be considered by the auditor in assessing the management control system and identifying problem area warranting more detailed audit include –

The use by management of standards or goals in judging accomplishment, productivity, efficiency in the use of goods or services.

Lack of clarity in written procedures, misunderstandings or inconsistent interpretations in the organisation may affect :-

— capabilities of personnel
— failures to accept responsibilities
— duplication of effort
— improper or imprudent use of funds
— cumbersome or extravagant organsational patterns
— ineffective or useful use of employees and physical resources.

This; listing is indicative of the kinds of factors that an alert management auditor must keep in mind in all his work. The knowledge gained in preliminary review that is conducted in recognition of these kinds of factors provides a solid basis for more detailed examination work that can lead to constructive improvements in the management system.

(b) **Techniques of management audit :**

Techniques employed by a management auditor in effectively carrying out his audit are –

(i) **Accounting or economic techniques**

(a) Break-even analysis

(b) Budgetary control including flexible budget system

(c) Cost management techniques indicating how an organisation's assets should be allocated over competing projects or to decide whether it is worth proceeding with the investment, keeping in view proportionate value of expenditure on such projects.

(d) Discounted cash flow and net present value methods.

(e) Cost benefit analysis.

(f) Standard costing and marginal costing

(g) Activity based costing to test the relevance of costs to activities.

(h) Quality analysis of company transactions.

(ii) **Scientific techniques**

(a) *Computer Models :* There are many types of problems which can be solved on a computer e.g. decision on material mix, product, mix, make or buy etc.

(b) *Network analysis :* To analyse strings of tasks to arrange them in sequential or parallel order to complete the project in shortest possible time.

(c) *Mathematical programming* solving by heuristic (trial and error) techniques to determine the best material mix, best use of organisation's transport fleet, the best mix of products to obtain, to maximize profits and optimum use of labour, finance, equipments, etc. Linear programming is usually effective when relationship vary in linear order whereas quadratic programming may be used when the variations are in the order of square root of some other factors.

(iii) **Statistical techniques**

(a) Activity sampling : It is one of the many ways in which the present workloads can be measured to obtain controls to be exercised by management.

(b) Monte Carlo Simulation : In this a number of variables are drawn from large statistical population which have equal choice of being selected and obtain the best sample possible.

(c) Exponential smoothing

(d) Interfirm comparison

(iv) **Personnel techniques**

(a) Attitude survey

(b) Ergonomic (Man-machine relationship)

(c) Training methods

(d) Profitability and productivity measurement

(v) **General techniques**

(a) *Statistical theory of management* is an attempt to emphasize what should be the practical approach to a problem by –

— Analyzing the problem to establish the basic difficulties and factors involved.

— Establish management by objectives.

— Identifying the likely ways of tackling the problems in the light of objectives to develop a solution.

— Determine the key factors affecting management decision-making.

— Evaluating alternative courses of action

— Evaluating each alternative in terms of economy, efficiency and best fit.

— Specifying the action required to exploit the situation to the best advantage of the organisation.

(b) Brain storming

(c) Transfer pricing

(d) Management by objectives

(e) Management by exception

(f) Corporate planning

(g) Information theory

Question 15:

(i) What are the points to be covered under efficient management audit programme?

(ii) What are the qualifications of a Management and Administrative Auditors?

Answer:

(i) An efficient management audit programme shall comprise the following:

(a) Review of the organisational objectives and plans

(b) Study of the policies and practices of the management

(c) A critical review of the organizational structure

(d) Study of the systems and procedures

(e) Evaluation of operations

(f) Study of the efficiency of the use of physical resources available

(g) Exercise of proper management control

(h) Maintain suitable monitoring system through management information system (MIS)

(i) Check on adherence to the statutory obligation and

(j) Above all, review the efficiency of manpower handling, which ultimately results in the organisation's success.

(k) An audit programme is laying down the path in its required details before conducting such audit.

A management auditor shall shrewdly assess weak and risk areas in the organisation and deal with such areas in more detail. He has to lay down a programme by making a list of such weak and risk areas and follow them up in his audit.

(ii) Qualifications of Management and Administrative Auditors.

Prime qualification of a management auditory is to process broad business experience in allied profession such as accountancy, statistics, engineering, marketing or administration. It is not possible that one person can possess all the specialized qualifications. But a special qualification in one field could have a respective view of the whole system. If a team of auditors is appointed it will be preferable to have people from different facilities, because a cross fertilisation of ideas from different business fields can be a stimulating factor. Management audit should aim at highlighting any team of administration or managerial efficiency or otherwise affecting the performance of the organisation.

The essential qualities of a management auditor are :-

(i) Ability to grasp the business problems
(ii) General understanding of the nature, purposes and objects of the organisation e.g. nationalized or government controlled organisation etc.
(iii) Ability to determine or assist the progress of the organisation
(iv) Knowledge of the principles of delegation of authority and control and the preparation of different budgets viz. cash budget, production budget, master budget, etc
(v) Power of grasping and understanding different internal control devices viz., flow chart, flow of work, analysis of work scheduling, use of computer, etc.
(vi) Sufficient knowledge about engineering statistical techniques, cost and management accounting, general financial accounting, production planning and control etc.
(vii) General understanding of different laws viz. company laws, tax laws, FEMA, MRTP, and other economic legislations.
(viii) Sufficient knowledge and experience in preparing various reports for submission to different levels of management including the top management
(ix) Tactfulness, perseverance, pleasing and dynamic personality.

Question 16:

(i) State the characteristics of a good management audit report?

(ii) As a management consultant, you have an assignment to conduct a Management Audit of the production function of a medium-scale engineering unit. Prepare a check list of the points on which you should undertake the study.

Answer:

(i) Characteristics of a good management audit report

The detailed characteristics of a good management audit report can be summarized as follows:

(i) Pertinence

(ii) Comprehensiveness

(iii) Brevity

(iv) Timeliness

(v) Motivating

(vi) Formatting

Contents of the report.

The top policy executive is generally interested in four factors in operating statements – facts, person responsible, deviations in actual performance from standards and the effect of the result on financial or physical status of the organisation.

The report must allow management to study comparisons, to review organisation, and to appraise the effectiveness of the executives. Departmental weakness can be quickly seen by the management, if the report is properly prepared.

Management audit report should create awareness among the management of prudent management practices that can make organisation come alive. It is vary important function of management audit to help change of management mind-set.

A management audit report should also be discussed with the people concerned in various areas before reporting. Every point that is raised in the report should have the acceptance of the people involved in the concerned function. A report that indicates suggestions that had come form the people themselves would have a better than coming as a suggestion from auditor.

The report should be drafted and structured so that it makes a logical presentation to the management and makes it easily readable. The report should contain not only the problems and defects in the working but also should come out with solutions as if given by the operational people themselves so that it gains immediate acceptance for implementation. A management audit report relies heavily on accepted managerial practices and feasible solutions.

(ii) Checklist for carrying out management audit of production function in a medium sized engineering unit:

1. How is the production plan prepared? Is it based entirely on market forecasts, or does it also take into account limitations of materials, personnel and finance?
2. Are the product-mix decisions based on optimum profitability? What is the proportion of standard products and tailor-made items?

3. Whether all infrastructure like machinery, materials, manpower and money have been assured at the scheduled time for uninterrupted production.
4. Are there any constraints in achieving maximum capacity utilization? Are there any imbalances in the plant? If so, what steps are being contemplated to set right the imbalance?
5. Is it possible to subcontract some jobs to increase production capacity or maintain production in times of power-cuts etc.?
6. What is the percentage of scrap, waste and rejects? Is it reasonable?
7. Is the idle time being monitored regularly? Is it being analysed reason-wise? How much of it is due to machinery breakdown which is controllable by production department?
8. Is there excess or shortage of manpower? How is the control exercised – time & motion study, incentives, labour budgets or any other means?
9. Is there any wastage in consumption of utilities like power, fuel, steam, compressed air, etc.?
10. How effective is the material handling system? Are there any avoidable movements of materials?
11. What is the system for preventive maintenance? If the in-house maintenance capability is not adequate, are there annual maintenance contracts for all important items of plant and machinery?
12. How is the control exercised on inventory of stores and spares?
13. What is the procedure to handle breakdown emergencies?
14. Are all statutory requirements in regard to safety measures complied with?
15. Are history cards available for all plant and machinery giving details of downtime, replacement of parts, etc?
16. Does the system provide for flexibility or change of production schedules to execute urgent orders or changes in the product mix?

Question 17:

(i) Prepare a checklist/questionnaire for management audit of the purchase function of a manufacturing company which has factories at different locations manufacturing the same range of products.

(ii) A company manufacturing consumer electronic goods has a fairly Research and Development set up. So far the company has been earmarking 2% of its turnover to R&D budget. Such an approach has so far paid ample dividends to the company. The company has been able to establish a reputation of introducing innovative products, which has excellent customer acceptability.

The company, however, is now worried that new players, some of whom are of international repute, entering Indian market, whether their R&D efforts are really giving them value for their money. Since your firm is well known consultancy firm, they have approached you to conduct a management audit of their R&D activities.

List out five major questions, which your audit will address.

Answer :

(i) A central purchase organisation which caters to the needs of several factories manufacturing the same range of products, should aim at economies of scale, as it is in a better bargaining position. At the same time, it should keep in mind the logistics aspects, i.e. cost of transporting the raw materials and components from a single source to different (may be far-flung) locations. The objective should be to ensure a more or less uniform delivered cost at each location. Where the transportation cost is significant, the buyer should try to source the components from a supplier who is the nearest to the point of consumption.

Apart from the above special features, the auditor of purchase function should look into the following major points :

(a) Organisation of purchase function, with special reference to the authorities who have been delegated powers for the following :

- Make purchase requisitions or authorize them
- Decide the vendors to whom enquiries should be sent
- Certifying the technical competence and production capacity of the vendors.
- Final selection of the vendor

(b) What is the machinery for the technical appraisal of the vendor's capacity and capability?

(c) Is there a regular vendor rating procedure and continuous monitoring of the performance of vendors?

(d) What is the procedure for issue of enquiries, preparing comparative statements and selection of supplier?

(e) Effectiveness of the market intelligence setup i.e., collection of data regarding various sources, building up a data base of products/suppliers/prices/technical specifications.

(f) Is there a separate setup for follow up of supplies and taking corrective action in case of delays?

(g) Are the terms of delivery standardised, or whether the purchase department is responsible for collection of stores from the vendors in some cases and the vendor responsible for delivery in some others? If the purchase department is responsible for collection, who is responsible for fixing transport charges?

(h) Is there close liaison between quality control (inward goods) and purchase department, so that quality complaints are brought to the notice of purchase department promptly?

(i) What are the built-in controls against misuse of purchasing powers?

(j) What is the quantum of emergency purchases in relation to total purchases? Are the reasons for emergency purchases analysed? - i.e. whether on account of vendor failure, or sudden change in production plans etc.

(k) Who certifies the payment of bills? Is the purchase department involved in deciding priorities for payment?

(ii) General principles of management audit :

The major five questions, which the management audit should address are :-

1. Selection process:

It is the project selection based on prediction of market needs or responding to the market needs? What are the mechanics of consultation between the market research group and R&D group? Would the success of percentage of projects be better if R&D follows the perception of market research or would the initial advantage of breakthrough in new area give the company a sharp competitive edge?

2. Collection of project wise R&D costs :

   Are the costs collected project wise? Is there an agreed format for collecting such costs? Have the terms used in the format agreed upon between the management accounts, who would be monitoring costs and R&D would be using the collected information?

3. Monitoring of costs :

   How are the R&D budgets prepared? At the time of approval of projects for research, are any efforts made to indicated the value expected to flow from the successful completion of the projects and an attempt to match the expected cost and anticipated benefits?

   Is there a regular system of responsibilities accounting? Are the accounting criteria like target rate of return, target pay back period, target net present value built into the system? Are the criteria understood and accepted by R&D group?

4. Parameters for suspending further work:

   Who takes the decision about suspending or scrapping a project initiated? What are the criteria used to arrive at such decision? If the criteria are already laid down, what is the process of authorizing deviation from such norms?

5. Customizing the results for production :

   When the project considered to be successful? How is the successful project customized for production? What are the responsibilities of R&D group in such customization vis-à-vis design and such other production support services.

Question 18:

Given below are the abridged balance sheets and profit & loss accounts of AB Spinning Mills Ltd. :

	1998-99	***1997-98***	***1996-97***
		(₹ In lakhs)	
Balance Sheet :			
Share capital	**245**	**245**	**245**
Reserves and Surplus	**726**	**1,077**	**1,313**
Long term borrowings	**287**	**180**	**160**
Working capital loans	**1,639**	**451**	**672**
Sundry creditors	**1,616**	**1,255**	**1,015**
Other Provisions	**389**	**315**	**305**

Total	4,902	3,523	3,710
Net block	1,009	541	612
Investments	19	19	19
Current assets :			
Inventory	1,160	1,521	1,641
Book Debts	11	114	172
Loans and advances	2,641	1,286	1,231
	62	42	35
Total	4,902	3,523	3,710
Profit & Loss Account:			
Sales	5,091	3,938	4,215
Other income	446	365	342
Total	5,537	4,303	4,557
Raw materials, stores and spares consumed	3,728	2,775	2,964
Factory wages	162	215	206
Salaries	377	322	295
Power and fuel	826	673	710
Repairs and maintenance:			
Buildings	7	18	15
Plant and Machinery	38	54	48
Vehicles	43	33	24
Depreciation:			
Buildings	11	14	16
Plant and machinery	57	43	48
Vehicles	66	26	30
Interest	277	130	152

Other overheads (excluding salaries and depreciation:)			
Factory overheads	**138**	**94**	**82**
Administrative overheads	**71**	**59**	**41**
Selling and distributing overheads	**87**	**83**	**80**
Loss for the year	**(-) 351**	**(-) 236**	**(-) 154**
Total	**5,537**	**303**	**4,557**
Sales for the year (Kgs.)	**4350890**	**3436921**	**3725405**

The bankers to the company appointed you as a Consultant for identifying the factors which have contributed to the continuing losses. Prepare a short note highlighting the factors which have prima facie led the company to sickness.

Answer :

Working notes	1998-99	1997-98	1996-97
Sales – quantity kgs.	43,50,890	34,36,921	37,25,405
Sales Value in Rs. Lakhs	5,091	3,938	4,215
Average sales realization per Kg.-Rs.	117	115	113
Raw Materials, stores & spares consumed (₹- Lakhs)	3,728	2,775	2,964
Material cost as % of sales value (%)	73.2	70.5	70.3
Direct wage cost % of sales value (%)	3.2	5.4	4.9
Observations:			

From the above figures, it is apparent that the Company's declining profitability is NOT due to market conditions as revealed by the following factors :

(a) The sales price has been marginally increasing year to year.

(b) The very small increase in material cost is also in step with the increase in sales realization.

(c) The company has been able to control direct labour cost effective.

(d) The level of production has been maintained and has in fact improved in the latest year.

(e) Inventory and book debt levels have been brought down considerably.

On the other hand, the following factors present a disturbing picture and lead to the inference that the financial management is either incompetent, or the management was diverted the borrowed working funds to some other activity or invested in unproductive assets like vehicles:

	1998-99	1997-98	1996-97
Long term borrowings	287	180	160

Working capital loans	1639	451	672
Net block	1009	541	612
Loans & advances	2641	1286	1231
Depreciation, repairs & maintenance of vehicles	109	59	54
Interest	277	130	152

The increase in working capital borrowings and the consequent interest thereon were not warranted, especially when the funds blocked in inventory and book debts have come down. The additional interest burden and additional expenses on vehicles amount to Rs. 197 lakhs whereas the increase in loss as compared to the previous year is only Rs. 115 lakhs.

Preliminary conclusion:

(i) Prima facie, it appears that the unit has become sick due to diversion of funds by the management to other activities or for personal expenditure.

(ii) The fixed assets have doubled. But there is no profit accruing by the increased assets.

Question 19:

(i) Explain whether the following activities amount to professional misconduct :

(a) A Cost Accountant takes voluntary retirement from his employer and starts practice. He continues his association with his previous employers as an advisor, on a monthly retainer.

(b) A practicing lawyer specializing in anticipating cases comes to an informal understanding with an independent practicing Cost Accountant to assist him in preparing accounting statements to support his cases, and agrees to share his fees on a percentage basis.

(c) A Cost Accountant gives a certificate of cost for a product manufactured by an SSI unit owned entirely by his son.

(ii) Prepare the checklist for Production Function check.

Answer :

(i) Professional Misconduct:

(a) As the accountant has severed his connection with his previous employer as an employee and acts only in an advisory capacity, which is a legitimate activity of a practicing cost accountant, it does not amount to misconduct.

(b) Although the practicing cost accountant can accept the assignment for preparing the necessary statements for the antidumping cases for a specified fee, the sharing of total fees on a percentage basis between the lawyer and cost accountant amounts to an informal partnership between them, which is prohibited. Therefore, this practice falls under the definition of misconduct.

(c) The Second Schedule to the Cost and Works Accountants Act, 1959 stipulates that a Cost Accountant in practice shall be deemed to be guilty of professional misconduct if he expresses his opinion on cost or pricing statements of any business or enterprise in which he, his firm or a partner in his firm has a substantial interest, unless he discloses the interest also in his report. Strictly speaking, a cost accountant issuing a certificate for a unit in which he has no direct interest is in order. However, as in this case the factory is owned by the cost accountant's son it would be prudent on the part of the accountant to desist from issuing such a certificate on moral grounds.

(ii) Production Function Checks

(a) How are the production requirements for raw materials communicated to the purchasing function?

(b) How is the production scheduled and controlled against the schedule?

(c) Are these methods suitable for the type, size and complexity of the production processes?

(d) What is the system for amendments to the production schedule?

(e) How is rescheduling carried out when production is not to schedule, or there are machinery or labour troubles?

(f) What methods are used to control the supply of raw materials for production?

(g) How are labour requirement determined?

(h) What system is there for ensuring good utilisation for machinery and what statistics on the subject are available?

(i) Similarly, what is the system for ensuring good utilisation of labour and what statistics on this subject are available?

(j) What is the inspection system during production and at the final product stage?

(k) How are scrap items to be re-worked and controlled?

(l) What methods are used for forecasting the production levels that will be required for the future months/years?

(m) How is scheduled production broken down into its constituent items, to be produced at times which will make them available when required to merge with the part forming the finished product?

(n) Are there efficient preventive maintenance programs for production equipment and machinery?

(o) Is replacement cost information readily available for major items of plant?

Question 20:

(i) Given below is the Trading and Profit and Loss Account of a Company for the year ended 31st March, 2012:

	₹			₹
To Materials	**27,40,000**	**By Sales**		**60,00,000**
To Wages	**15,10,000**	**(60,000 units)**		
To Factory Expenses	**8,30,000**	**By Stock (2,000 units)**		**1,60,000**
To Admn. Expenses	**3,82,400**	**By Work-in- Progress**	**₹**	
To Selling Expenses	**4,50,000**	**Materials**	**64,000**	

To Preliminary		**Wages**	**36,000**	
Expenses		**Factory Expenses**	**20,000**	**1,20,000**
Written off	**60,000**	**By Dividend received**		**18,000**
To Net Profit	**3,25,600**			
	62,98,000			**62,98,000**

The Company manufactures standard units. In the Cost Accounts:

(i) Factory expenses have been allocated to production at 20% of Prime Cost;

(ii) Administrative expenses at ₹ 6 per unit produced; and

(iii) Selling expenses at ₹ 8 per unit sold.

Prepare the Costing Profit and Loss Account of the company and reconcile the same with the profit disclosed by the Financial Accounts.

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

Answer:

(i) Costing Profit & Loss Account

	₹		₹
To Materials (*Working Note 1)*	26,76,000	By Sales	60,00,000
To Wages (*Working Note 2)*	14,74,000	By Closing Stock (*Working Note 4)*	1,72,646
To Factory Expenses (20% of Prime cost viz ₹ 41,50,000) (*Refer to Working Note 3)*	8,30,000		
To Administration Expenses (@ ₹ 6 p.u. x 62,000 units)	3,72,000		
To Selling Expenses (@ ₹ 8 p.u. x 60,000 units)	4,80,000		
To Net Profit	3,40,646		
	61,72,646		**61,72,646**

Reconciliation Statement

	₹	₹
Profit as per Cost Accounts		3,40,646
Add: Dividends not included in Cost Accounts	18,000	
Factory Expenses overabsorbed in Cost Accounts (₹ 8,30,000 - ₹ 8,10,000)	20,000	
Selling overheads overabsorbed in Cost Accounts (₹ 4,80,000 – ₹ 4,50,000)	30,000	68,000
		4,08,646
Less: Preliminary expenses not included in Cost Accounts	60,000	
Administrative expenses under absorbed in Cost Accounts (₹ 3,82,400 – ₹ 372,000)	10,400	

Closing stock overvalued in Cost Accounts (₹ 1,72,646 – ₹ 1,60,000) *(Refer to Working Note 4)*	12,646	83,046
Profit as per Financial Accounts		3,25,600

Working Notes:

1. Material = ₹ 27,40,000 – ₹ 64,000 = ₹ 26,76,000
2. Wages = ₹ 15,10,000 – ₹ 36,000 = ₹ 14,74,000
3. Prime Cost = Materials +Wages = ₹ 26,76,000 + ₹ 14,74,000= ₹ 41,50,000
4. Closing Stock Value

$$= \left(\frac{\text{Material Cost+Wages+Factory Expenses+Admn. Expenses}}{\text{62,000 units}}\right) \times 2000$$

$$= \frac{₹\ 53,52,000}{62,000} \times 2,000 = ₹\ 1,72,646$$

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

- That the work-in-progress has been physically verified and it agrees with the quantity shown in job-cards of uncompleted work.
- 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.
- 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.
- That the volume and value of work-in-progress is not disproportionate as compared with finished production.

Question 21:

(i) The input , output and labour costs process-wise are given below:

Process	Input M.T.	Output M.T.	Direct Labour cost of the process (₹)
A	72000	64800	194400
B	75000	66000	264000
C	108000	99360	496800
D	90000	83250	666000

Calculate "Direct labour cost per unit of the product under reference" as required in para 5(4) of the Cost Audit Report.

(ii) What points to be kept in view by the Cost Auditor while furnishing information under para 5 of the annexure to the Cost Audit Report under Cost Audit Report Rules, 2011?

Answer:

(i) 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=₹ 3

B 264000/66000=₹ 4

C 496800/99360=₹ 5

D 666000/83250=₹ 8

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

Process A = ₹ 3

Process B=(₹ 3*1.1364)+ ₹ 4=₹ 7.4092

Process C=(₹ 7.4092*1.0870)+ ₹ 5= ₹13.0538

Process D=(₹ 13.0538*1.0811)+ ₹ 8=₹ 22.1125

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

(ii) The following points are to be kept in view by the Cost Auditor while furnishing information under para 5 of the annexure to Cost Audit Report :

(a) Separate Cost Statement shall be prepared for each product/activity group.

(b) The items of cost shown in the Proforma are indicative and same should be reflected keeping in mind the materiality of the item of cost in the product/activity group.

(c) The Proforma may be suitably modified to meet the requirement of the industry/ product/activity group.

(d) In case the company follows a predetermined or standard costing system, the above cost statement should reflect figures at actual after adjustment of variances, if any.

(e) Where ever, there is any significant variation in the current year's figure over the previous year's figure for any item shown under each para of the Annexure to the Cost Audit Report, reasons thereof shall be given by the Cost Auditor.

(f) If the duration of the current year or previous year is not twelve months , same shall be clearly indicated in the Report.

Question 22:

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

Liabilities	₹ In lacs	Total (₹ in Lacs)	Assets	₹ in Lacs	Total (₹ in Lacs)
Share Capital		**11200**	**Gross Block**	**115600**	
Reserves& Surplus:			**Less: Depreciation**	**31200**	**84400**
General Reserve	**25000**		**Capital WIP**		**3000**
Share	**36200**		**Investments**		**8800**

Premium					
Revaluation Reserve	**13600**	**74800**	**Current Assets, Loans & Advances:**		
Secured Loan:			**Inventories**	**26400**	
Term loan	**34400**		**Sundry Debtors**	**12800**	
Cash Credit	**12000**	**46400**	**Cash & Bank Balances**	**2480**	
Current Liabilities & Provisions		**38000**	**Advances to suppliers of Equipment**	**4800**	
			Other Advances	**17600**	**64080**
			Miscellaneous Expenses carried forward		**10120**
		170400			**170400**

The profit after interest provision of ₹ 2600 lacs for the same period was ₹ 7060 lacs. Compute the following figures/ratios as stipulated in para 9 of Annexure to Cost Audit Report(for the company as a whole):

(a) Capital employed

(b) Net worth

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

(d) Profit as a percentage of capital employed.

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

Answer:

(a) Capital Employed: ₹ in lacs

Net Block		84400
Less: Revaluation Reserve		13600
Add:Current Assets	64080	
Less :Advances to suppliers for equipment	4800	59280
Less:Current Liabilities		38000
Total capital employed		92080

(b) Net worth ₹ in lacs

Share capital	11200
+General Reserve	25000
+Share Premium	36200
Total	72400
Less: Misc. Exp .c/f	10120
	62280

(c) Net worth as a percentage of long term borrowings: ₹ in lacs

i)Networth	62280
ii)Long term borrowing	34400
(i) as a %age of (ii) (62280/34400*100)	181.05%

(d) Profit as a percentage of capital employed. ₹ in lacs

Profit after interest	7060
Interest	2600
Profit before interest	9660
Profit as a %age of capital employed =9660/92080*100	10.49%

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

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

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

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

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

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

(f) that allocation of overheads between finished products and unfinished products is in accordance with correct principles.