FINAL
Group IV
Paper 19 : COST AND MANAGEMENT AUDIT
(SYLLABUS – 2016)

PART – I : MULTIPLE CHOICE QUESTIONS

(1) Choose the correct option among four alternative answer. (1 mark for correct choice, 1 mark for justification.)

(i) Rule 6 of the Companies (Cost Records and Audit) Rules, 2014 deals with:
(A) Application of Cost Records
(B) Application of Cost Audit
(C) Appointment of Cost Auditor
(D) Cost Audit Report.

(ii) Cost of self generation Utilities for own consumption shall comprise of:
(A) Administrative Overheads
(B) Distribution Cost
(C) Factory overheads
(D) None of the above.

(iii) Product and Profitability Statement (For audited products/services) is shown under ______________ of Annexure to Cost Audit Report.
(A) Part A
(B) Part B
(C) Part C
(D) Part D

(iv) Any casual vacancy in the office of a cost auditor, shall be filled by the Board of Directors within _______________ days of occurrence of such vacancy.
(A) 180
(B) 90
(C) 30
(D) 60

(v) The Companies are required to maintain Cost Records if turnover exceeds ____________ crores or more during immediately preceding Financial Year in respect of the products and services specified.
(A) ₹25
(B) ₹30
(C) ₹35
(D) ₹10

(vi) Which one of the following is not a professional misconduct in relation to Cost Accountants in Practice as per the First Schedule of The CWA Act, 1959?
(A) discloses information acquired in the course of his professional engagement to any person other than his client so engaging him, without the consent of his client, or otherwise than as required by any law for the time being in force;

(B) allows any person to practice in his name as a cost accountant unless such person is also a cost accountant in practice and is in partnership with or employed by himself
(C) accepts or agrees to accept any part of the profits of the professional work of a person who is not a member of the Institute:
(D) secures, either through the services of a person who is not an employee of such cost accountant or who is not his partner or by means which are not open to a cost accountant, any professional business:

(vii)CAS 9 deals with
(A) Direct Material Cost
(B) Indirect Material Cost
(C) Packing Material Cost
(D) Imported Material Cost.

(viii)Operational Audit is a _______________ Level Management Audit.
(A) Macro
(B) Micro
(C) Depends on situation.
(D) None of the above

(ix) Exemptions from application of the Rules are provided to Companies whose revenue from exports, in foreign exchange, exceeds ________________ of total revenue and companies operating from Special Economic Zones.
(A) 45%
(B) 50%
(C) 75%
(D) 80%

(x) In XBRL Format process of determining the elements that correspond to lines and columns in a financial statement and which elements must be created by extension is:
(A) Mapping
(B) Label
(C) Hierarchy
(D) Scaling

Ans:

(i) (C) Appointment of Cost Auditor. According to Rule 6(1) , the category of companies specified in Rule 3 and the thresholds limits laid down in Rule 4, shall within one hundred and eighty days of the commencement of every financial year, appoint a cost auditor.

Provided that before such appointment is made, the written consent of the cost auditor to such appointment, and a certificate from him or it, as provided in sub-rule (1A), shall be obtained.

(ii) (C) Factory overheads. As per CAS 8, cost of self generated utilities for own consumption shall comprise direct material cost, direct employee cost, direct expenses and factory overheads.

(iii) (D) Part D. Pursuant to Rule 6(4) of the Companies (Cost Records and Audit) Rules, 2014.

(iv) (C) 30. Pursuant to Rule 6(3A) of the Companies (Cost Records and Audit) Rules, 2014.

(iv) (C) ₹35. Pursuant to Rule 3 of the Companies (Cost Records and Audit) Rules, 2014.

(v) (A) discloses information acquired in the course of his professional engagement to any person other than his client so engaging him, without the consent of his client, or otherwise than as required by any law for the time being in force;

It is a misconduct as per the Second Schedule, Part I of the CWA Act, 1959

(vi) (C) Packing Material Cost. This standard deals with the principles and methods of determining the Packing Material Cost.

(vii) (B) Micro. The objective of operational audit is to appraise the effectiveness and efficiency of a division, activity, or operation of the entity in meeting organizational goals.

(ix) (C) 75%. The requirement of Cost Audit under these rules shall not apply to companies whose revenue from exports in foreign exchange exceed 75% of total revenue and companies operating in special economic zone.

(x) (A) Mapping. This is as per XBRL glossary. Several technical terms are used, that have specific meanings, in the context of using XBRL.

PART – II : SUBJECTIVE QUESTIONS

2. a) Is maintenance of cost accounting records mandatory for a multi-product company where all the products are not covered under the Rules even if the Turnover of the individual product/s that are covered under the Rules is less than rupees thirty five crores?

b) What is the difference between Cost Accounting policy and Cost Accounting system?

Ans:

a) The Companies (Cost Records and Audit) Rules, 2014 provide threshold limits for the company as a whole irrespective of whether all its products are as per the prescribed industry/sector provided under Table A or Table B. The Rules do not provide any minimum product specific threshold limits for maintenance of cost accounting records and consequently the company would be required to maintain cost accounting records for the products covered under Table-A or Table-B or both even if the turnover of such products is below rupees thirty five crores.

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

3. a) Whether separate Form CRA-2 is required to be filed by a company having two or more different types of products covered under cost audit?

b) Whether companies registered under Section 8 of the Companies Act, 2013 (corresponding to Section 25 of the Companies Act, 1956) and One Person Company (OPC) introduced in Companies Act, 2013 covered under the Companies (Cost Records and Audit) Rules, 2014?

Ans:

a) CRA-2 Form (intimation for appointment of cost auditor to Central Government) has replaced the earlier Form 23C (application seeking approval for appointment of Cost Auditor). A single Form CRA-2 is required to be filed providing details of the sectors/industries covered under cost audit and details of cost auditor. For Companies appointing multiple cost auditors, only one single Form CRA-2 is required to be filed. Provision has been made in the Form to accommodate details of multiple cost auditors

b) The Companies (Cost Records and Audit) Rules, 2014 are applicable to every company registered under the Companies Act, 2013 which are engaged in production of goods or providing of services listed in Table-A or Table-B of Rule 3. Different threshold limits have been prescribed in the Rules for applicability of maintenance of cost accounting records and coverage under cost audit. Exemption has been granted only to companies which are classified as a micro enterprise or a small enterprise including as per the turnover criteria under sub-section (9) of section 7 of the Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006) and foreign companies having only liaison offices engaged in Production, import and supply or trading of medical devices specified under Item 33 of Table-B of Rule 3. Any other legal entity registered as a company that meets the conditions stated in Rule 3 and Rule 4 are covered.

4. a) Is a Cost Auditor required to give any certificate with respect to his/her independence and 'arm's length relationship' with the appointing company?

b) Briefly state the disclosure and transparency requirements for Corporate Governance.

Ans:

a) Yes, The Cost Auditor of a company is required to give a certificate to the Audit Committee in respect of his/her/its independence and arm's length relationship with the company.

Also, according to the Second Schedule , Part 1 clause 4 of the The Cost and Works Accountants Act , 1959 it amounts to professional misconduct when a Cost Auditor 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;

b) The company should ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the company.

(i) Information should be prepared and disclosed in accordance with the prescribed standards of accounting, financial and non-financial disclosure.
(ii) Channels for disseminating information should provide for equal, timely and cost efficient access to relevant information by users.
(iii) The company should maintain minutes of the meeting explicitly recording dissenting opinions, if any.

(iv) The company should implement the prescribed accounting standards in letter and spirit in the preparation of financial statements taking into consideration the interest of all stakeholders and should also ensure that the annual audit is conducted by an independent, competent and qualified auditor.

5) State whether the following amounts to professional misconduct by a CMA.

a) A practicing member/firm maintains branch office in India – each under the separate charge of a member of The Institute of Cost Accountants of India/other Institutes.

b) An advertisement notifying changes in address/partnership, dissolution etc., by the PCA (Practicing Cost Accountant).

Ans:

a) As per Clause 4 of the First Schedule Part 1 of the Cost and Works Accountants Act , 1959, A cost accountant in practice shall be deemed to be guilty of professional misconduct, if he/she enters into partnership, in or outside India, with any person other than a cost accountant in practice or such other person who is a member of any other professional body having such qualifications as may be prescribed, including a resident who but for his/her residence abroad would be entitled to be registered as a member under clause (iv) of sub-section (1) of section 4 or whose qualifications are recognised by the Central Government or the Council for the purpose of permitting such partnerships. So it will not be a misconduct only if the charge of the branch office is given to a CMA. But it will definitely be misconduct to hand over charge to member of any other Institute who is not a CMA.

b) As per Clause 7 of the First Schedule Part 1 of the Cost and Works Accountants Act , 1959, A cost accountant in practice shall be deemed to be guilty of professional misconduct, if he/she advertises his/her professional attainments or services, or uses any designation or expressions other than cost accountant on professional documents, visiting cards, letter heads or sign boards, unless it be a degree of a University established by law in India or recognised by the Central Government or a title indicating membership of the [Institute of Cost Accountants of India] or of any other institution that has been recognised by the Central Government or may be recognised by the Council. So advertisement notifying changes in address/partnership, dissolution etc is permitted and will therefore not be a misconduct.

6) Answer the following questions with reference to CAS 24.
(i) What do you understand by 'Revenue from operations'?
(ii) What do you understand by 'Net Sales Realisation'?
(iii) What is meant by 'waste'?
(iv) What is 'reporting period'?

Ans:

(i) Revenue from operations: is the income arising in the course of the ordinary activities of an entity from the sale of goods or rendering of services. Revenue from operations represents income arising from the sale of goods or rendering of services and includes other operating revenue, such as sale of scrap, government subsidies, or incentives received. Revenue from operations is generally recognised at the net value excluding indirect taxes.

(ii) Net Sales Realization: is the revenue from operations net of discounts and indirect taxes.
(iii) Waste: Material lost during production or storage and discarded material which may or may not have any value. Example of waste is hard waste and soft waste in textile industry.
(iv) Reporting Period: is the period for which the cost statements are prepared.

7. a) As a part of management strategy SEASENA LTD. manufacturing soaps, purchased a popular soap brand 'SUNFLOWER' from a smaller company.
What will be treatment of such costs and the disclosure to be made in the Cost Statements as per relevant Cost Accounting Standard?

b) The particulars of a Supervisory employee of MAHAVINA LTD., a manufacturing company show the annual expenses as follows:
(i) Basic pay including Industrial D.A. ₹7,00,000
(ii) Lease rent paid for accommodation provided to the employee ₹2,40,000
(iii) Amount recovered from employee ₹60,000
(iv) Employer's contribution to P.F. ₹56,000
(v) Employee's contribution to P.F. ₹56,000
(vi) Reimbursement of medical expenses ₹67,000
(vii) Hospitalization expenses including Group Medical Insurance borne by the employer ₹19,000
(viii) Annual Bonus ₹30,000
(ix) Festival Advance ₹30,000
(x) The Employer manages P.F. through a Trust, and the shortfall in the return of the Trust Account compared to the notified rate is around 0.75% p.a. reimburse to the Trust.
(xi) The future benefit (Gratuity) to the employee is insured with L.I.C., the premium of which costs 4% p.a. approx.

Required:
Calculate the Employee Cost for the year ended March 31, 2016- keeping in view of Cost Accounting Standard (CAS)-7.

Ans:

a) The expenses paid or incurred for purchase of a brand is lump-sum in nature and purchased for the increase in revenue income over a long period of time. As per Cost Accounting Standard 10, expenses which are in the nature of 'one - time' payment, shall be amortized on the basis of the estimated output or benefit to be derived from such direct expenses. The expenses for which the benefit is ensued in the future period shall be equated with the estimated production/service volumes for the effective period and based on volume achieved during the Cost Accounting period. Accordingly, the charge for amortization shall be determined. In the given situation, the company is likely to be benefitted from the brand image of the product and the costs so amortized be treated as Selling Expenses over the estimated life of the brand image.

As per cas-10, the cost statements on direct expenses shall normally disclose the following:
1. The basis of distribution of Direct Expenses to the cost objects/cost units.
2. Quantity and rates of items of Direct Expenses, as applicable.
3. Where Direct Expenses are accounted at standard cost, the price and usage variances.

4. Direct expenses paid/payable to related parties.
5. Direct Expenses incurred in foreign exchange.
6. Any subsidy/Grant/incentive/credit/recoveries and any such payment be reduced from Direct Expenses.

Disclosure shall be made only where expenses are material, significant and quantifiable and be made in the body of the Cost Statement or as a foot note or as a separate schedule.

b) Computation of employee cost: (As per principles laid down in CAS-7)

	Particulars	Amount in ₹
i)	Basic pay (including industrial DA)	7,00,000
	Add: Leased Accommodation (2,40,000-60,000)	1,80,000
	Medical Expenses (67,000+19,000)	86,000
	Annual Bonus	30,000
	Contribution to P.F	56,000
	Premium for Gratuity (@ 4% on 700000)	28,000
	Total: Employee Cost	1080000

Note:
(i) Festival advance is a recoverable amount-not to be included in employee cost.
(ii) Employee's computation to PF is not a cost to employer- not to be included in employee cost.
(iii) Shortfall in PF the return of Trust A/c is an unusual cost- not to be included in employee cost.

8) How would compute Pollution Control Cost as per CAS-14 in the following circumstances?
a) Pollution Control Jobs carried out by outside contractors.
b) Pollution control Jobs carried out by contractor at its premises.
c) Pollution Control activity carried out by outside contractors inside the entity.

Ans:

(i) As per CAS-14, Cost of Pollution Control Jobs carried out by outside contractors shall include charges payable to the contractor and cost of materials, consumable stores, spares, manpower, equipment usage, utilities and other costs incurred by the entity for such jobs.
(ii) As per CAS-14, Cost of pollution Control Jobs carried out by contractor at its premises shall be determined at invoice or agreed price including duties and taxes and other expenditure directly attributable thereto net of discounts (other than cash discount) taxes and duties refundable or to be credited.
This cost shall also include the cost of other resources provided to the contractors.
(iii) According to CAS-14, cost of pollution control activity carried out by outside contractors inside the entity shall include charges payable to the contractor and cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other costs incurred by the entity for such jobs.

9) Answer the following questions with respect to Cost Auditing standard 101.
i) What is the objective of the standard?
ii) What are the relevant factors in formulating overall audit strategy?
iii) What do you understand by the term 'initial audit'?

Ans:

i) The objective of this Standard is to guide the members in planning for the audit of cost statements so that it is performed in an efficient and effective manner. Audit planning shall also include establishing the overall audit strategy and audit plan for the conduct of the audit.

ii) In formulating the Overall audit strategy, the Cost Auditor shall consider all relevant factors.
These relevant factors include:
(a) results of preliminary activities
(b) knowledge from previous audits and other engagements with the auditee
(c) knowledge of business
(d) nature and scope of the audit
(e) statutory deadlines and reporting format
(f) relevant factors determining the direction of the audit efforts
(g) nature, timing and extent of resources required for the audit.

Matters that are relevant in formulating the overall audit strategy and drawing up the audit plan include, in addition to those mentioned earlier, the following
(a) The cost reporting framework generally prescribed, under the Companies Act and Rules prescribed thereunder, as well as under any other law as applicable, on the basis of which the cost information to be audited has been prepared, including need for reconciliation with financial reporting framework.
(b) Industry regulators' requirement as to how costs will be handled.
(c) Unique features of an industry that influence audit requirements such as definition of product in the newspaper industry.
(d) Reliance that can be placed on the work of financial auditors, other cost auditors appointed by the entity and internal auditors. such as their attendance in annual stocktaking
(e) State of IT (Information Technology) implementation, whether the entity is using an ERP (Enterprise Resource Planning) system or internally developed systems and the reliance that can be placed on them. (f) Statutory timelines for cost reporting, which can be modified by the management for early completion.
(g) Timelines for Board/ audit committee meetings, which can set the time limits for completion of audit work.
(h) Resources required and available in terms of manpower, equipment and others and the assignment of these to specific parts of the work.

(iii) Initial Audit: Initial audit means an audit where:-
(a) The entity is subject to audit for the first time, as per the applicable laws, or
(b) The audit of the entity for the prior period was conducted by a different audit firm.

10) Answer the following questions with respect to Cost Auditing standard 103.
i) What is the objective of the standard?
ii) What are the overall objectives of a Cost Auditor?
iii) What do you understand by the term 'misstatement'?

Ans:

i) The objective of this Standard is to lay down the overall objectives of the Cost Auditor and ensuring the Conduct of the Audit of Cost Statements in accordance with the Cost

Auditing Standards. The objective of this Standard is to lay down the overall objectives of the Cost Auditor and ensuring the Conduct of the Audit of Cost Statements in accordance with the Cost Auditing Standards.

ii) The Cost auditor's overall objectives are:

(1) to obtain reasonable assurance about whether the cost statements as a whole are free from material misstatement, whether due to fraud or error, and to enable the auditor to express an opinion whether the Cost Statements are prepared, in all material respects, in accordance with the applicable Cost reporting framework, Cost Accounting Standards(CAS) and Generally Accepted Cost Accounting Principles (GACAP) as issued by the Institute, and give a true and fair view of the Cost of a product, activity or service. In the case of a Cost Audit under the Companies Act and Rules prescribed thereunder, the objective is to express an opinion on whether the Cost Statements subject to audit represent a true and fair view of the cost of production, cost of sales and margin of products covered by the Cost Audit.

(2) to report on the cost statements in the form required by law or by the Cost Auditing Standards in accordance with the auditor's findings. Where reasonable assurance cannot be obtained, the cost auditor should qualify the opinion and in extreme cases disclaim an opinion. The Cost Auditors objective may extend to making observations and suggestions where required by applicable regulations.

(iii) Misstatement: A difference between the amounts, classification, presentation or disclosure of a reported cost statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable cost reporting framework. Misstatements can arise from error or fraud.

Where the cost auditor expresses an opinion on whether the cost statements give a true and fair view, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the cost auditor's judgment, are necessary for the cost statements to be presented fairly, in all material respects, or to give a true and fair view.

11) The profit as per Cost Accounts of RUKMANI SUGAR MILLS LTD for the year ended March 31, 2018 was ₹1,30,46,200. In the course of Cost Audit, you come across the following differences between the Financial Accounts and Cost Accounts.

(A) Element of Profit on self-consumption of sugar included in Financial Accounts was ₹ 75,000.
(B) A sum of ₹ 32 Lakhs has been paid during the year towards Additional Sales Tax for previous years and included in current year Rates and Taxes.
(C) Income (dividend) from investment booked in Financial Accounts was ₹ 2,90,000 (D) Loss on Sale of investments — ₹ 6,000
(E) Profit on Sales of fixed Assets accounted in F/A was ₹ 6,25,000.
(F) A sum of ₹15,00,000 had been written off in the financial A/c as new Project development expenses.
(G) Major consumables written off in full in the Financial A/cs be treated as deferred revenue expenditure amortized over three years in the Cost Accounts full value of ₹ 24,00,000.
(H) Insurance claim relating to previous years received during the year ₹ 54,00,000.
(I) Loss from trading Activity ₹ 11,20,000.
(J) Voluntary Retirement Compensation included in Salary & Wages in F/A - 26,50,000.

(K) Increase in value of work in-progress and finished goods inventory was as follows:

As per Financial Accounts	**₹ 18,30,000**
As per Cost Accounts	**₹ 16,15,000**

You are required to prepare a reconciliation statement between Profit figures as per Cost and Financial Accounts and Also show the Profit as per Financial Accounts for the year ended March 31, 2018.

Ans:

RUKMANI SUGAR MILLS LTD.
RECONCILIATION OF PROFIT AS PER COST ACCOUNTS WITH PROFIT AS PER FINANCIAL ACCOUNTS FOR THE YEAR ENDED MARCH 31, 2018

(Amount in ₹)

Profit as per Cost Accounts		1,30,46,200
Add: Incomes not considered in Cost Accounts		
(A) Element of profit on self consumption of sugar	75000	
(B) Income from Investments	290000	
(C) Profit on sale of Fixed Assets	625000	
(D) Insurance claim received relating to previous year	54,00,000	63,90,000
Less, Expenses not considered in Cost Accounts:		
(A) Additional sales tax paid or previous years	32,00,000	
(B) New project development expenses	15,00,000	
(C)Expenditure fully written off in Financial A/c but treated as deferred revenue(the deferred portion only)	16,00,000	
(D) Loss from Trading Activity	11,20,000	
(E) Loss on Sale Investments	6000	
(F) Voluntary Retirement compensation included in salary and Wages in F/A	26,50,000	1,00,76,000
Add: Difference in Valuation of Stock:		
Increase in inventory as per F/A	18,30,000	
Increase in inventory as per Cost Accounts	16,15,000	
Valuation in F/A is higher		215000
PROFIT AS PER FINANCIAL ACCOUNTS		**95,75,200**

12. The Financial Profit and Loss of M/s. VGM Manufacturing company Ltd. for the year is ₹ 28,75,000. During the course of cost audit, it is noticed the followings:

(i) Some Old assets sold off which fetched a profit of ₹ 1,25,000

(ii) Interest was received amounting to ₹ 45,000 from outside the business investment.

(iii) Work-in-progress valuation for financial accounts does not as a practice take into account factory overhead. Factory overhead is ₹ 2,15,000 in opening W-I-P and ₹ 2,45,000 in closing W-I-P.

(iv) The Company was engaged in Trading activity by purchasing goods of ₹ 11,15,845 and selling at ₹ 13,12,850 after incurring ₹ 35,000 as expenditure.

(v) A major overhaul of machinery was carried out at a cost of ₹ 5,50,000 and next such overhaul will be dome only after five years.

(vi) Opening stock of Raw material and finished good was overvalued for ₹ 2,00,000 and closing stock was overvalued ₹ 1,85,000 in financial records.

Work out the profit as per Cost Accounts.

Ans:

Profit as per Financial Accounts		28,75,000
Add: 1 Difference in valuation of W-I-P	30,000	
2 Proportionate charge i.e. four-fifth for overhaul of machinery	4,40,000	4,70,000
Less: 1 Profit on sale of old assets not included in Cost A/cs	1,25,000	
2 Interest received from outside investment	45,000	
3 Trading profit not included in cost accounts	1,62,005	
4 Difference in Raw material and finished stock valuation	15,000	3,47,005
Profit as per Cost Accounts		2,997,995

13) Discuss the following:

a) Evidence in Management Audit.

b) A Management Audit team should be multidimensional.

Ans:

a) In management audit, there are no fixed items of evidence that has to be checked by the management auditor on routine basis. A management auditor has to rely more on his experience to identify the areas of review, particularly the areas of weakness to overcome, strengths to be exploited, and risks to be properly covered.

The auditor's evidence comes through his discussions with concerned persons in the organizations, survey and review of various reports like internal audit reports, inspection reports, physical verification, monthly performance review statements, minutes and notes and above all personal observations.

Evidence may be gathered through sampling techniques and on basis of results drawn, going into details where required. It should be understood that a management auditor does not depend on voucher as an evidence, but shall fall back on various records including vouchers as evidence for his audit if sample demand so. The evidence should be such that an auditor can draw valid conclusions duly verifying the same with people concerned. There are no area of restrictions for obtaining evidence for a management auditor.

b) Management Audit is a service function with the object of assisting management in achieving the most efficient administration. Management audit involves multidisciplinary and multidimensional approach and requires systematic and dispassionate review of analysis and appraisal of overall performance. It takes into account the techno-economic study of the Industry. As a management auditor is concerned with all aspects of business and the organization, ranging from manufacture to marketing and finance, the management audit team should be multidisciplinary to make multidimensional approach to audit function.

14. Enumerate the circumstances which have brought about development of "Management Audit".

Ans:

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.

The following factors have led to the development of "Management Audit"

✓ Size, scale and complexity of business operations:
The very size and scale of business operations have lent complexity to the affairs of the organizations. Eventually a stage comes when further development /expansion is either uneconomic or unmanageable. In order to deal with problems of complexity, a number of techniques and tools have been developed out of which Management Audit is one such technique- basically meant to overcome the human limitations of top management.

✓ Need to improve productivity:
The industrial development to-day is characterized by a continuous search for improvement of productivity-cum- efficiency through utilization of resources- national, physical, human and capital because of their constraints and limitations. This has called in for Management audit to cope up in a world of diminishing resources. Granting financial subsidy by Government/Financial Institutions to sick enterprise is preceded by identification of problems, as faced by the company. This calls for the necessity of Management Audit.

✓ Takeover Bids:
When a business firm plans to acquire another business enterprise/The Government desires to take over any enterprise, the acquiring organization needs to study and evaluate fundamentally the other firm's financial, technical and managerial aspects- which call for a Management Auditor's study.

✓ Societal Need:
A business unit today has to meet the needs of society in order to survive. Management Audit will be able to guide company for industrial management of social well being.

✓ Equity participation:
LIC , IFC, UTI and different financial Institutions may like to conduct Management Audit of the company before deciding for equity participation.

✓ Foreign Collaboration
The foreign collaborators while investing funds in the associated companies may feel the necessity of conducting Management Audit of those units for which collaboration agreement is likely to be finalized. This will ensure that the funds are invested for growth and expansion.

15) What is productivity audit? Describe the steps involved and the measures used in this audit.

Ans:

Productivity audit is the process of monitoring and evaluating organizational practices to determine whether functions, programmes, and organization itself are utilizing resources effectively and efficiently so as to accomplish objectives.

It is measured in terms of outputs and inputs in relation to the three major factors of production i.e. material , labour and capital. The measurement used in relationship between outputs and inputs measured in physical and/or financial terms.

Productivity audit concentrates on areas such as
i) productivity actions
ii) resource availability
iii) performance standards
iv) benefit allocation
v) productivity policies
vi) equipment usage
vii) accountability reporting
viii) resource allocation.

The measures of productivity for three factors of production:

Material productivity:	i)	Obtaining higher output for same input.
	ii)	Obtaining same output with lower input
Labour productivity:	i)	Labour hour per unit of product.
	ii)	Output per man hour.
	iii)	Added value per capita or per rupee of labour cost.
Capital productivity:	i)	Physical output per rupee of investment.
	ii)	Value of production per rupee of investment.
	iii)	Value added per rupee of investment.

The audit is done by
i) Ratio analysis
   - Return on capital employed
   - Return on sales
ii) Capacity utilization of plant, equipments and facilities against available capacity
iii) Material consumption against bench marks.
iv) Productivity analysis of man hours in time and cost.

Productivity audit consists of following steps:
i) Setting of standards for different factors of production.
ii) Choosing yardsticks for measurement of each of the factors.
iii) Comparing actual performance with standards and identifying variances.
iv) Making recommendations for control action.

16) A nationalized bank which has extended cash credit to a manufacturing company on the security of the inventory holding, is periodically receiving stock statements from the company indicating the value of stocks held. The company is sick and the Bank wants to reassure itself that its loans are fully covered by stocks. You have been appointed by the

Bank to certify the value of the inventory. How would you proceed to conduct the 'inventory audit?'

Ans:

Inventory Audit involves the following aspects:
(i) Physical verification of stocks.
(ii) Method of valuation adopted.
(iii) Currency of stocks (i.e., movement)

(i) Physical verification of stocks — Physical verification of stocks will normally be 100 percent. However, depending upon the nature of items and material flows, it may be done by sampling. This will require proper sampling procedures to ensure the samples verified represent the characteristics of entire stock. An ABC categorization may be done so that right emphasis is given to each item of stock.

(ii) Method of valuation adopted — The main thrust of inventory audit is to check the accuracy of the costs, to verify the market rates and to see that the values adopted for stock valuation are cost price or net realisable value whichever is lower. Basis of valuation adopted for Raw Materials, Work-in process, Finished Goods and Spares and Consumables must be examined and reasonableness verified to ensure the realizable values. For imported items foreign exchange translation rate for conversion will be : (a) as per bank debits under LC, or (b) rate prevalent as evidenced by Bill of Entry(or Forward Rate if Forward Contract has been taken (for imports on D.A. terms or on account).

(iii) Currency of stocks— Currency of stocks will be ensured by analyzing all items by fast, slow and non-moving characteristics. In respect of slow and non-moving items, fall in value, if any, due to obsolescence, deterioration etc. will also have to be examined and reported. In respect of spare parts, care must be taken to segregate items of spares relating to scrapped or replaced plant/machinery, as these may not have any value. In finished goods also, returns from customers for defects in quality must be given special consideration in valuation.

(iv) The basis of the unit rates adopted must be consistent and include:
   (a) Freight, insurance, octroi, packing, loading and unloading and other incidental charges incurred.
   (b) Manufacturing costs upto stages of completion in case of finished product. The report may be designed by the bank or designed by the Cost Auditor. In any case some items which need to be highlighted should be shown separately. The report should contain lacuna, if any, improvements required, and suggestions for improvement. Needless to say the report should not only be useful to client, i.e., bank but also to the unit whose audit is carried out to enable them to improve their performance.

17) Today's customer is more demanding than the customer of yesterday. In view of the this, how would you evaluate, as a management Auditor, the performance of "Customer Services Department"?

Ans:

A customer is the most important person for a business because it is he who provides the profit. Therefore, the starting point in marketing strategy is identifying the customers, their needs and organizing the efforts of the company towards satisfying such needs. In order to create and sustain the customers, right quality of goods must be supplied to them at right price and right time. If the customers are rightly and properly attended, it will stimulate the demand for the products of the company and help to establish product acceptability and widen the scope of potential customers. Performance of "Customer Services Department" may be evaluated on the following lines:

i) Product related policies and practices:

(a) Do products manufactured meet the needs of the customers of different classes, different taste and different purchasing power.
(b) Whether prices include reasonable profit?
(c) Whether prices are reasonable, consistant with quality and efficiency variations?
(d) Whether prices fixed are based on market conditions or Government regulations?
(e) Whether customers derive maximum benefit from after sales service?
(f) Whether the details of information given to customers regarding company profile, service, policy etc. adequately disseminated?
(g) Whether the department undertakes adequate research with regard to product, consumer behaviour so as to enhance customer satisfaction?
(h) Whether constant efforts are made to improve use value of the product?
(i) Whether product development program undertaken meet only short term needs or long term goals? Do the development programs consider the factors of standardization, simplification and specialization? (j) Whether company policies and practices relating to distribution of products among different sections of customers are fair and reasonable?

ii) Customer relationship:

(a) Whether the customer's complaints are handled promptly and efficiently?
(b) Whether the department is prompt in replying to the queries of customers relating to the product or service?
(c) Whether the labels of the products contain adequate information to help customers to appreciate the quality and other characteristics of the product?
(d) Whether the company is co-operative with consumer associations?
(e) Whether the company provides useful guidance and render necessary assistance to Consumer' Co-operatives for distribution of quality products at reasonable prices?

(iii) General considerations:

(a) Whether safety norms relating to the product are as per accepted standards laid down by statutory bodies such as ISI, BSS etc?
(b) Whether performance guarantees are explicitly stated?
(c) Whether the technical data given in sales promotional media specific and not ambiguous?
(d) Whether features of the product conform to the merits as per advertisements?
(e) When the distribution network is large, how does the department handles customer complaints?
(f) How does the department combat artificial scarcities?
(g) Whether all warranties and procedure for invocation of them explicitly stated?
(h) Whether the fundamental aspect of servicing responsibility to customers recognized by the department as a policy measure?
(i) Whether there are instances of relaxation of policy norms in respect of responsibilities to customers even when distribution of goods is made through middlemen?

18) How should a Cost and Management Auditor evaluate MIS of an organization?

Ans:

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

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

i) Content, quality and source of information;
ii) Flow of information
iii) Correlation of information in decision areas.

These points are discussed in detail in the below:

i) Content, quality and source of information include the following:
   1) Whether the information collected is relevant to the decision problem so as to improve the quality of decisions?
   2) Whether the reporting of MIS is uniform and regular both for financial and nonfinancial information?
   3) Whether the information adequately caters to the needs of the decision makers?
   4) Whether unwanted data is included in the information?
   5) Whether the manager uses the data effective or merely as a post mortem exercise?

ii) Flow of information: A cost auditor has to proceed on the following lines:
   I) <u>System organization:</u>
      A) Whether the system is centralized or decentralized?
      B) How the information flows from various units to the control section?
      C) Estimating the volume of data involved, transmission time and cost.
      D) Benefit-cost analysis of centralized vs. decentralized information.

   II) <u>Data collection and management</u>: Appraisal includes the following points:
      A) Data collection methods,
      B) Filtration and classification of data.
      C) Matching of data with decision problems.
      D) Extent of study carried out by management with regard to existing frequency.
      E) Constraints if any in the system design.

   III) Correlation of information in decision areas. The cost auditor is required to appraise this aspect from the following angles:
      A) Whether input- output analysis is attempted?
      B) Whether MIS helps in reducing uncertainty?
      C) Cost effectiveness of MIS.
      D) Effectiveness of information supplied to users.
      E) Provision of feedback by MIS for corrective action.
      F) Ability of MIS to optimize the value of information.

19) (a) Which section of the Companies Act 2013 deals with Internal Audit. State the provisions.

(b) Which companies are required to constitute Audit Committees? What is its responsibility regarding internal audit.

Ans:

(a) Section 138 of the Companies Act 2013 deals with provisions of Internal Audit. As per section 138,

(1) Such class or classes of companies as may be prescribed shall be required to appoint an internal auditor, who shall either be a chartered accountant or a cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.

(2) The Central Government may, by rules, prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board.

(b) The Board of directors of every listed company and the following classes of companies, as prescribed under Rule 6 of Companies (Meetings of Board and its powers) Rules, 2014 shall constitute an Audit Committee:

(a) all public companies with a paid up capital of ₹10 Crores or more;

(b) all public companies having turnover of ₹100 Crores or more;

(c) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding ₹50 Crores or more.

The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this Rule.

Responsibility of audit committee is to review adequacy of internal audit function and internal audit reports.

20) As an internal auditor of DEF Ltd. the Managing Director has asked you to enquire into the causes of abnormal wastage of raw materials during the month of September, 2017. The wastage percentages are as follows:

June, 2018	**1.3%**
July, 2018	**1.1%**
August, 2018	**1.4%**
September, 2018	**3.8%**

How will you proceed to carry out the Assignment?

Ans:

The rate of wastage in September, 2018 has risen sharply as compared to previous months. Under the circumstances, before setting for detailed investigation, the internal auditor need to understand the manufacturing environment right from the stage of purchase of materials, the movement of stock flow through the production process while its becomes finished goods. To locate the reasons for the abnormal wastage, the internal auditor should first of all assess the general requirements as under:

(i) Procure a list of raw materials, showing the names and detailed characteristics of each raw material.

(ii) Obtain the standard consumption figures, and ascertain the basis according to which normal wastage figures have been worked out. Examine the breakup of a normal wastage into that in process, storage and handling stages. Also obtain control reports, if any, in respect of manufacturing costs with reference to predetermined standards.

(iii) Examine the various records maintained for recording separately the various lots purchased and identification of each lot with actual material consumption and for ascertaining actual wastage figures therein.
(iv) Obtain reports of Preventive Maintenance Programme of machinery to ensure that the quality of goods manufacture is not of sub-standard nature or leads to high scrap work.
(v) Assess whether personnel employed are properly trained and working efficiently.
(vi) See whether quality control techniques have been consistent or have undergone any change.
(vii) Examine inventory plans and procedures in report of transportation storage efficiency, deterioration, pilferage and whether the same are audited regularly.
(viii) Examine whether the basis adopted for calculating wastage for September is the same as was adopted for the other three months.
(ix) Obtain a statement showing break up of wastage figures in storage, handling and process for the four months under reference and compare the results of the analysis for each of the four months.

Some specific reasons for abnormal wastage in process specific may be considered by the auditor are as under:
(A) Examine laboratory reports and inspection reports to find out if raw materials purchased were of a poor quality or were of sub-standard quality. This will be most useful if it is possible to identify the wastage out of each lot that has been purchased.
(B) Machine breakdown, power failure, etc. may also result into loss of materials in process. Check the machine utilisation statements.
(C) A high rate of rejections in the finished lots may also be responsible for abnormal wastage; therefore, examine the inspectors' reports in respect of inspection carried out on the completion of each stage of work or process.
(D) It is possible that the wastage may have occurred because the particular lot out of which issues were made in September, 2011 was lying in the store for a long time, leading to deterioration in quality or because of a change in the weather which may have led to the deterioration. Compare the wastage figures of September, 2010 with those of September, 2011.
(E) Abnormal wastage in storage and handling may arise due to the following reasons:
    (i) Write offs on account of reconciliation of physical and book stocks: In case of periodical physical stock taking, such write offs will be reflected only in the month such reconciliation takes place.
    (ii) Accidental, theft or fire losses in storage: The auditor should examine the possibility of these for the purpose.
(F) Examine whether any new production line was taken up during the month in respect of which standard input-output ratio is yet to be set-up.

21) Premiere manufacturer Ltd. received an enquiry for 2,50,000 numbers of special type of machine parts. Capacity of the company exists for manufacturing the parts, but a fixed investment of ₹ 95,000 and working capital of to the extent of 35% of Sales value will be required to undertake the job.

The cost estimates are as follows:
Raw materials 40,000 kg. at ₹ 3.00 per kg.
Labour hours 12,000 of which 800 would be overtime payable at double the normal rate.
Labour rate ₹ 3.00 per hour
Factory overhead ₹ 2.50 per direct labour hour.

Selling and distribution overhead expenses ₹ 5,400
Material recovered at the end of operation will be ₹ 12,000 (estimated)
The company expects a net return of 15% on capital employed.

As a Management accountant of the Company, you are requested to prepare Cost and Price Statement, indicating the price to be quoted by the Company to the Customer.

Ans:

Statement of Estimated Cost and Price Quotation

Product – Special type Machine parts
Quantity – 2,50,000 units

Particulars	₹	₹
Materials 40,000 kg at ₹ 3 per kg.	1,20,000	
Less: estimated scrap value	12,000	1,08,000
Labour – (12000 – 800) hours at ₹ 3 per hour	33,600	
(800 hours of Over Time hours at ₹ 6/-	4,800	38,400
Prime Cost		1,46,400
Add: Factory overhead (12000 hrs at ₹ 2.50)		30,000
Factory cost		1,76,400
Add: Selling and distribution overhead		45,400
Total cost		2,21,800
Add: Profit		26,674
Sales		2,48,474

Selling price per unit ₹ 0.9939

Notes:
Calculation of Sales
Let Sales be S
S = Total Cost + 15% of capital employed
S = 221800 + 15/100 x (95000 + 0.35 of S) S = 221800 + 0.15(95000 + 035 S)
S = 221800 + 14250 + 0.05 S S - 0.05S = 236050
0.95 S = 236050
S = 236050 / 0.95 = 248474
Working Capital requirement = 35% Sales = 0.35 x ₹ 2,48,474 = ₹ 86,966

22) In a manufacturing shop, product P requires 2 man hours and Product Q requires 6 man hours. In a month of 26 working days of 8 hours a day 2000 unit of P and 1000 unit of Q were produced. The Company employs 60 workers in the shop and the budgeted man-hours are 1,08,000 for the year. You are required to workout capacity ratio, activity ratio and efficiency ratio.

Ans:

Budgeted hours for the year = 108000 Hrs for the year
= 9000 for the month Maximum possible hours
= 26x8x60 workers
= 12480 Hrs Actual hours worked
= Maximum possible hours worked
= 12480 Hrs.

Standard hours produced

Product P = 2000 x 2 =	4,000 Hrs.
Product Q = 1000 x 6 =	6,000 Hrs.
	10,000 Hrs.

(i) Capacity ratio
Standard capacity usage ration = Budgeted/maximum possible hours x 100
= 9000/12480 x 100
= 72.12%

Actual capacity usage ratio = Actual hour worked/maximum possible hours
= 12480/12480 x 100
= 100.00%

(ii) Activity Ratio = Actual production in terms of Standards Hrs/Budgeted Hrs.
= 10000/9000x100
= 111.11%

(iii) Efficiency Ratio = Actual production in Standard Hour / Actual hours worked
= 10000/12480 x 100
= 80.13%

23) A Special task force is engaged for reviewing the low profit for M/S Ramnagar Textile Mills Ltd. After the review the Task force gave the following report:

The Company has 1248 looms working two shifts per day. There are 26 sections of 48 looms each. Each section has 24 weavers and a jobber. Thus there are 1300 direct labourers other than indirect labourers. The production is 20 lakh metres per month and realised ₹ 10 per metre. The average wage is ₹ 1,200 per month and fixed cost amounts to ₹ 2,25,000 per month. The product cost is ₹ 6 per metre in addition to Direct wages. The working time is between 7 a.m. to 12 mid-night comprising two shifts with half an hour interval.

The following suggestions are to be considered:

(i) Labour productivity can be improved by changing lay out of the machines.
(ii) Given the availability of space with the proposed change, only 1008 looms can be reinstalled, with 48 looms in each section.
(iii) Technically a section of 48 looms can be run with 13 weavers, a helper and a jobber. In such situation the salary per head will increase by ₹ 200 per month. There will be some drop in production per loom. The company is not in favour of retrenchment of labour.
(iv)The Company can run a third shift between 12 mid-night to 7.00 a.m. with half an hour interval. However full salary is to be paid for six and half hour work.
(v) Only 20 lakh metres are sold at present at ₹ 10 per metre. Balance production are to be sold in export market at ₹ 8 per metre.
(vi) An initial stage, the Company can switch to 3 shifts working with 12 sections having 25 direct labour each and 9 sections having 15 direct labour each. The production in 3 shifts will be 25 lakh metres. Additional fixed cost will be ₹ 1 lakhs per month.

With the implications of the proposal for the company calculate profitability and advice to Company. (You may make suitable assumptions)

Ans:

Statement of Profitability

Particulars	Present	Proposed
No. of Looms	1248	1008
No. of shifts	2	3
No. of sections	26	21
No. of sections (with 25 hands in each section @ ₹1,200 p.m.)	25	12
No of section (with 15 hands in each section @ ₹1,400 p.m.)		9
Total no. of Direct labours employed	1,300	1,305
Expected Production (Lakh metres)	20	25

Profit statement (per month) **(₹)**

Particulars	Present	Proposed
Sales revenue	20,000,000	24,000,000
Cost:		
Production cost (₹6 per metre)	12,000,000	15,000,000
Direct Wages	15,60,000	16,47,000
Fixed Cost	2,25,000	3,25,000
Total Cost	1,37,85,000	1,69,72,000
Profit per month	6,21,5000	7,02,8000
Increase in profit	8,13,000	
Therefore the proposal is accepted.		

Working Notes:
No. of Looms/ looms per section = 1008 /48 = 21 sections

No. of employees employed
Present = (25 persons × 26 sections × 2 shifts) = 1300 workers

Proposed= (25 person × 12 section × 3 shifts) + (15 person × 9 section × 3 shifts) = 1305 workers

Direct wages per month
Present = (1300 × 1200) = 15,60,000
Proposed= (25 ×12 × 3 × ₹1200) + (₹1400 × 15 × 3× 9) = 16,47,000

Sales revenue per month
Present= (20,00,000 × ₹10) = 20,000,000
Proposed = (20,00,000 × ₹10) + (5,00,000 × ₹8) = 24,000,000

24) Given below are abridged Balance Sheet and Profit and Loss Account of M/S Festive Cloth Mills Ltd.

(₹ In Lakhs)

Balance Sheet	**2016-17**	**2015-16**	**2014-15**
Share capital	**345**	**345**	**345**
Reserves and surplus	**302**	**795**	**1140**
Long term borrowing	**687**	**380**	**160**
Working capital Loan	**1563**	**823**	**582**
Sundry creditors	**1258**	**900**	**775**
Other Provisions	**587**	**325**	**305**
TOTAL	**4742**	**3568**	**3307**

Net Fixed Assets	**1168**	**756**	**625**
Investment	**15**	**15**	**15**
Current assets			
Inventory	**1025**	**1013**	**947**
Book debt	**210**	**185**	**175**
Loans and advances	**2263**	**1558**	**1515**
Cash and bank balances	**61**	**41**	**30**
TOTAL	**4742**	**3568**	**3307**

(₹ In Lakhs)

Profit and Loss Account	**2016-17**	**2015-16**	**2014-15**
Sales	**5038**	**4315**	**4465**
Other Income	**428**	**325**	**347**
TOTAL	**5466**	**4640**	**4812**
Raw material and stores spares	**3675**	**3045**	**3262**
Factory wages	**275**	**232**	**206**
Salaries	**428**	**375**	**256**
Power and fuel	**812**	**628**	**710**
Repair and maintenance			
Building	**7**	**12**	**15**
Plant and machinery	**39**	**53**	**47**
Vehicles	**42**	**35**	**20**
Depreciation			
Building	**11**	**15**	**17**
Plant and machinery	**54**	**45**	**42**
Vehicles	**65**	**28**	**31**
Interest	**245**	**180**	**154**
Other overhead excluding salaries and Depreciation			
Factory overhead	**145**	**104**	**82**
Administrative overhead	**73**	**60**	**40**
Selling and distribution overhead	**88**	**83**	**80**
Loss for the year	**(493)**	**(255)**	**(150)**
Total	**5466**	**4640**	**4812**
Sales for the year (kgs)	**4950896**	**3836855**	**3725245**

Banker to the company appointed you as a consultant to identify 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.

Ans:

Working notes:	**2016-17**	**2015-16**	**2014-15**
Sales-Quantity (Kg.)	4950896	3836855	3725245
Sales value ₹ in lakhs	5038	4315	4465
Average Sales realization per Kg.	102	112	120
Raw material stores & spare consumed (₹ in	3675	3045	3262
Material as percent of a sales value (%)	72.9	70.5	73.1
Direct wages as percent of sales value (%)	5.5	5.4	4.6

Observation:

From the above figures it may be seen that the companies declining profit is not due to market condition as revealed by the following factors.

(a) The Sales price per kg has been marginally decreasing year to year.
(b) Material Cost has decreasing from year to year.
(c) The Company has been able to control direct labour cost effectively.
(d) The level of production has been maintained and improved over the years.
(e) Inventory and Book debt level have remained within the limit in spite of increase in sales activity.

On the other hand the following factors present negative impact on Profitability and Balance sheet of the Company.

	2016-17	**2015-16**	**2014-15**
Long term borrowing	687	380	160
Working capital loan	1563	823	582
Net Fixed assets	1168	756	625
Loans and advances	2263	1558	1515
Depreciation, repairs & maintenance of vehicles	107	63	51
Interest	245	180	154

The increase in long term borrowing is reflected in the increase of net assets. But the net assets have not been utilized in the activity of production. Therefore it may be construed that Long term borrowing utilized in the unproductive assets or personal assets.

Increase in working capital loan has been utilized in Inventory and Book debts and Loans and advances. Since the loan has been increased in alarming manner the interest has been increased. This reflects the weak financial management of the Company.

Conclusion:

(i) It appears that the unit has become sick due to diversion of funds by management to other activities or for personal expenditure.
(ii) The Net fixed assets have been increased there is no corresponding increase in Profit/Turnover.

25) Selected statistics of Sagar & Company Limited for two years, are given below:

(Amount in ₹ Lakh)

	31.03.2017	**31.03.2016**
Gross profit	**36%**	**$33\frac{1}{3}\%$**
Stock turnover	**20 times**	**25 times**
Average Stock	**₹38,400**	**₹36,000**
Average Debtors	**₹87,500**	**₹1,68,750**
Income Tax rate	**50%**	**50%**
Net Income after tax as % of Sales	**6%**	**7%**
Maximum Credit period allowed to customers	**60 Days**	**60 Days**

You are required to:

(i) Prepare a statement of profits in comparative form for all the two years.
(ii) Evaluate the position of the company regarding profitability and liquidity on the basis of information supplied to you.
(iii) What additional information will you require to evaluate fully the position of the company on the liquidity fund?

Ans:

(i) Statement of Profit of Sagar & Company Limited for the Year ended 31.03.2017 & 31.03.2016

	31.03.2017 (₹)	31.03.2016 (₹)
Sales	12,00,000	13,50,000
Less: Cost of Goods Sold	7,68,000	9,00,000
Gross Profit	4,32,000	4,50,000
Less: Operating Expenses	2,88,000	2,61,000
Profit before taxes	1,44,000	1,89,000
Less: Taxes	72,000	94,500
Net Profit	72,000	94,500

(ii) The Profitability of the Company is consistently improving. Its liquidity position, judged terms of debtors and stock turnover ratios, can be said to be very satisfactory. The stock turnover ratio being as high as 20 times. The debtors turnover ratios are also very high.
For 31.03.2014 = ₹ 12,00,000 ÷ ₹ 87,500 = 13.7 times
For 31.03.2013 = ₹ 13,50,000 ÷ ₹1,68,750 = 8.0 times

(iii) The amount of current liabilities and current assets, other than debtors and stock, are required to evaluate fully the position of the company on the liquidity front.

Workings :

(1) Year 2017,
Cost of Goods Sold =Stock Turnover × Average Stock = 20 × ₹ 38,400 = ₹ 7,68,000
Sales = ₹7,68,000 × 100/ 64 = ₹ 12,00,000
Net Income = 6% on ₹12,00,000 = ₹ 72,000
Therefore, Profit before tax ₹ 1,44,000

(2) Year 2016,
Cost of Goods Sold = Stock Turnover × Average Stock = 25 × ₹ 36,000 = ₹ 9,00,000
Sales = ₹9,00,000 × 100/ 66% = ₹ 13,50,000
Net Income = 7 % on ₹13,50,000 = ₹ 94,500
Therefore, profit before tax ₹ 1,89,000.

26) The following figures relate to usage of power for a product:

	2014 -15	**2015-16**	**2016 -17**
Total power consumed to KWH	**2402474**	**2494872**	**2175677**
Rate KWH (₹)	**2.29**	**2.12**	**1.90**
Total production in million kgs.	**337.73**	**333.084**	**300.865**

Compute necessary productivity measures and compare the efficiency of power usage during the three years.

Ans:

	2014-15	**2015-16**	**2016-17**
Power consumed in Kwh	24,02,474	24,94,872	21,75,677
Rate per Kwh (₹)	2.29	2.12	1.90
Total Power cost (₹)	55,01,665	52,89,129	41,33,786
Production (in million kgs)	337.730	333.084	300.865
	(337730 MT)	(333084 MT)	(300865 MT)
Power cost/MT (₹)	16.29	15.88	13.74
Power usage MT (KWH)	7.11	7.49	7.23

Variances over previous year:		
Rate (₹)	4,24,128 (F)	4,78,649 (F)
Volume (₹)	75,683 (F)	5,11,638 (F)
Usage (₹)	2,87,275 (A)	1,65,056 (F)
	2,12,536 (F)	11,55,343 (F)

Calculation of variances:
Rate variance:

	2014-15	2015-16	2016-17
Total power consumed (Kwh)	24,02,474	24,94,872	21,75,677
Rate per Kwh (₹)	2.29	2.12	1.90
Rate variance		24,94,872×(2.29-2.12) = ₹4,24,128 (F)	21,75,677×(2.12-1.90) = ₹4,78,649 (F)
Production in Million (Kgs)	337.730	333.084	300.865

Volume variance:
2016-17 & 2015-16 (333084 – 300865) × 15.88 = ₹5,11,638 (F)
2015-16 & 2014-15 (337730 – 333084) × 16.29 = ₹75,683 (F)

Usage variance:
2016-17 & 2015-16: 11,55,343 – 4,78,649 – 5,11,638 = ₹1,65,056 (F)
2015-16 & 2014-15: 2,12,536 – 4,24,128 – 75,683 = ₹2,87,275 (A)

Total variance:
2016-17& 2015-16 52,89,129 – 41,33,786 = ₹11,55,343 (F)
2015-16 & 2014-15 55,01,665 – 52,89,129 = ₹2,12,536 (F)

27) The following is the abridged Balance Sheet of SARATHI LTD., a single product manufacturing Company:

Year ended 31st March	2018	2017
	(Amount in ₹ Lakh)	
LIABILITIES:		
Share Capital	**600**	**600**
Reserves & Surplus:		
Debenture Redemption Reserve	**50**	**60**
Capital Subsidy from State Government	**60**	**60**
Revaluation Reserve	**250**	**280**
General Reserve	**320**	**240**
Profit & Loss A/c	**96**	**64**
Secured Loans:	**550**	**590**
Unsecured Loans:	**246**	**234**
Total:	**2172**	**2128**

Year ended 31st March	2018	2017
	(Amount in ₹ Lakh)	
ASSETS:		
Gross Block	**1450**	**1360**
Accumulated Depreciation	**(630)**	**(580)**
Net Block	**820**	**780**
Capital Work-in-Progress	**86**	**74**
Investments	**30**	**30**

Current Assets, Loans & Advances:		
Inventories	**834**	**882**
Sundry Debtors	**364**	**390**
Advances for Equipments	**48**	**34**
Other Loans & Advances	**288**	**274**
Cash and Bank Balances	**42**	**38**
Current Liabilities & Provisions:		
Sundry Creditors for Capital Expenses	**(34)**	**(42)**
Sundry Creditors for Others	**(370)**	**(394)**
Provision for Taxes	**(128)**	**(142)**
Miscellaneous Expenditure	**192**	**204**
Total:	**2172**	**2128**

Additional information is available:

(i) Term Loans repayable in 12 months included under 'Secured Loans' are ₹192 lakh (Previous year ₹ 168 lakh).

(ii) Profit before Tax (PBT) for the year ended March 31, 2018 is ₹160 lakh (Previous year ₹174 lakh).

You are required to compute the following figures/ratios as stipulated in PARA 4, Part D of the Annexure to Cost Audit Report under Companies (Cost Records and Audit) Rules 2014, for the year ended March 31, 2018:

(i) Capital Employed;

(ii) Net Worth;

(iii) Debt-Equity Ratio;

(iv) PBT to Capital Employed;

(v) PBT to Net Worth.

Ans:

SARATHI LTD

(i) Capital Employed	Amount in ₹ Lakh			
			31.03.2018	31.03.2017
Gross Block			1450	1360
Less: Depreciation			630	580
Net Block			820	780
Less: Revaluation Reserve			250	280
Net Fixed Assets			570	500
	31.3.2018	31.3.2018		
Current Assets: (A)				
Inventories	834	882		
Sundry Debtors	364	390		
Loans and Advances	288	274		
Cash and Bank	42	38		
	1528	1584		
Current Liabilities: (B)				
Creditors – others	370	394		
Provisions for taxes	128	142		
Loans due in 12 months	192	168		
	690	704		
Working Capital (A-B)	838	880	838	880
CAPITAL EMPLOYED			1408	1380

Average Capital Employed: (1408+1380)/2 = ₹ 1394 lakh
Capital Employed for the year ended March 31, 2018: ₹ 1394 lakh

(i) Net worth	Amount in ₹ lakh 31.03.2018
Share Capital	600
Debenture Redemption Reserve	50
Capital Subsidy	60
General Reserve	320
Profit & Loss A/c	96
Equity	1126
Less: Miscellaneous Expenditure	192
Net Worth	934
(ii) Debt – Equity Ratio	**Amount in ₹ lakh 31.03.2018**
Debt: Secured Loans	550
Unsecured Loans	246
	796
Less: due in 12 months	192
	604
Equity as in above (ii)	1126
Debt-Equity Ratio (604 ÷ 1126) X 100	53.64% or, 0.5364:1
(iii) PBT to Capital Employed: ₹ (160 ÷1394) lakh x 100	11.48%
(iv) PBT to Net worth: (160 ÷ 934) x 100	17.13%

28) The following figures are extracted from Accounts of IREVNA LTD., a single product manufacturing company:

Year ended 31st March	2018	2017	2016
	(Amount in ₹ lakh)		
Gross Sales including Excise duty:	2,856	2,779	2,625
Excise Duty	413	392	371
Raw materials consumed	1,596	1,484	1,365
Direct wages	49	45	38
Power and fuel	42	38	34
Stores and spares	8	7	5
Depreciation charges to production cost centres	22	21	18
Factory Overheads:			
Salaries and wages	7	6	4
Depreciation	3	3	3
Rates and taxes	1	1	1
Other Overheads	8	7	6
Administrative Overheads:			
Salaries and Wages	14	13	11
Rates and taxes	3	3	3
Other Overheads	231	216	207
Selling and Distribution Overheads:			
Salaries and wages	10	8	7
Packing and forwarding	8	8	7
Depreciation	1	1	1
Other overheads	174	165	151

Interest	**119**	**104**	**95**
Bonus and Gratuity	**17**	**14**	**13**
Current Assets	**1,176**	**1,014**	**896**
Current Liabilities and Provisions	**454**	**427**	**344**

You are required to compute the following ratios as per requirement of PARA-4, Part D to the Annexure of the Companies (Cost Records and Audit) Rules 2014:
(i) Profit Before Tax (PBT) to Value Added
(ii) Value Added to Net Sales;
(iii) Profit Before Tax (PBT) to Net Sales.

Ans:

IREVNA LTD
(Calculation of Profit Before Tax) (PBT)

Year ended 31st March	2018	2017	2016
	(Amount in ₹ Lakh)		
Gross Sales inclusive of Excise duty	2,856	2,779	2,625
Excise duty	413	392	371
NET Sales (A)	2,443	2,387	2,254
Cost of Sales			
Raw Material Consumed	1,596	1,484	1,365
Direct Wages	49	45	38
Power and Fuel	42	38	34
Stores & Spares	8	7	5
Depreciation charged to production centres	22	21	18
Factory overheads (including Depreciation):	19	17	14
Administration Overheads	248	232	221
Selling and Distribution Overheads (inclusive depreciation):	193	182	166
Interest	119	104	95
Bonus and Gratuity	17	14	13
Total (B)	2,313	2,144	1,969
Profit Before Tax (PBT) (A-B)	130	243	285

Calculation of Valued Added:

Year ended 31st March	**2018**	**2017**	**2016**
	(Amount in ₹ Lakh)		
Net Sales (A)	2,443	2,387	2,254
Less: Cost of Bought out of Inputs:			
Direct Materials Consumed	1,596	1,484	1,365
Stores & Spares	8	7	5
Power & Fuel	42	38	34
Overheads (exclusive salaries & wages, rates & taxes and Depreciation)	421	396	371
Total Cost of Bought out of Inputs (B)	2,067	1,925	1,775
VALUE ADDED (A-B)	376	462	479

NOTE : Value Addition is defined in Para-3, Part D of the Companies (Cost Records and Audit) Rules-2014 as "the difference between Net output value (Net Sales) and Cost of bought out inputs for the product/service under reference".

Year ended 31st March	2018	2017	2016
	(Amount in ₹ Lakh)		
(i) Profit Before Tax (PBT) to Value Added as (%)	130/376 34.57%	243/462 52.60%	285/479 59.50%
(ii) Value Added to Net Sales as (%)	376/2443 15.39%	462/2387 19.35%	479/2254 21.25%
(iii) Profit Before Tax (PBT) to Net Sales as (%)	130/2443 5.32%	243/2387 10.18%	285/2254 12.64%

29) ENRON INDUSTRIES LTD. a manufacturing unit, provides the following extracts from its records for the year ended March 31, 2018:

The companies specifications capacity for a machine per hour	**1,600 units**
No. of shifts (each shift of 8 hours)	**3 shifts**
Paid holidays in a year (365 days):	
(i) Sundays	**52 days**
(ii) Other holidays	**10 days**

Annual maintenance is done during the 10 other holidays
Preventive weekly maintenance is carried on during Sundays.
Normal idle capacity due to lunch time, Shift changes etc= 1 hour per shift.
Production based on sales expectancy in past 5 years are: (unit in lakh) = 81.28, 93.86, 70.20, 83.73 and 81.70 respectively.

Actual production during the year: 84.50 lakh units. You are required to calculate
(i) Installed capacity;
(ii) Actual capacity utilization;
(iii) Normal capacity;
(iv) Normal Idle capacity;
(v) Abnormal idle capacity--keeping in view of the relevant Cost Accounting Standard (CAS-2).

Ans:

ENRON INDUSTRIES LTD

Calculation of Different Capacities:

(I) INSTALLED CAPACITY: 365 X 8 X3 X 1600 = 140.16 lakh Units

(ii) ACTUAL CAPACITY UTILIZATION: [(84.50)/140.16] x100 = 60.29%
(iii) NORMAL CAPACITY: (81.28 +83.73 + 81.70) Lakh Units ÷3 = 82.24 Lakh unit
(iv) NORMAL IDLE CAPACITY: = Installed capacity – normal capacity
=140.16 -82.24 lakh units
= 57.92 lakh units.
(v) ABNORMAL IDLE CAPACITY: Normal capacity- actual capacity utilization where actual capacity utilization is lower than normal capacity.

In the given problem actual capacity utilization is more than normal capacity. Hence question of abnormal idle capacity does not arise.

PART – III : SHORT QUESTIONS

30) (1) What is meant by 'Cost Records'?

(2) How the Demurrage Charges be treated as per the CAS 15?

(3) Explain the 'Ageing Analysis' of Receivables

(4) Explain 'Corporate Development Audit.'

(5) Who is the approving authority of the Company to fix the remuneration of the Cost Auditor? Who is the approving authority of the Company to fix the remuneration of the Cost Auditor?

(6) Whether each and every transactions with Related Parties is to be disclosed under Para D-5 of Annexure to the Cost Audit Report?

(7) A textile composite mills in the course of modernization issued voluntary retirement notice for 50 workers and the package cost ₹144.80 lakhs. This would amount to savings in wages of ₹260 lakhs over a period of 5 years. The package included closing down the Weaving Department. How would you treat separation cost due to voluntary retirement as per CAS-7 related to Employee Cost?

(8) SHANHITA LTD., a manufacturing company, producing Industrial chemicals had the following income during the year 2016-17.

Income:	(Amount in ₹ Lakhs)
Sales: Manufactured products	43,750
Traded products	2,830
Income from job Works	780
Sale of Defectives	130
Export Incentives	85
Cash Discount Received	35
Note: Sales inclusive of Excise Duty	2,840

Required:
Find out the Turnover of the company as per the Companies (Cost Records and Audit) Rules, 2014.

(9) How do you define 'Packing Material' as per the Generally Accepted Cost Accounting Principle? What is the treatment of such cost?

(10) What is eXtensible Business Reporting Language (XBRL)?

Ans:

(1) As per Rule 2 (e) the Companies (Cost Records and Audit) Rules 2014, 'cost records' means 'books of accounts relating to utilization of materials, labour and other items of cost as applicable to the production of goods or provision of services as provided in Section 148 of the Act, and these Rules'. There cannot be any exhaustive list of cost accounting records. Any transaction statistical, quantitative or other detail - that has a bearing on the cost of the product /activity is important and form part of the cost accounting records. Cost records are to be kept on regular basis to make it possible to

"calculate per unit cost of production/operations, cost of sales and margin for each of its product for every financial year on monthly/quarterly/half-yearly/annual basis"

(2) The CAS 15 deals with Selling and Distribution Overhead. As per CAS 15 any demurrage or detention charges, or penalty levied by transportation or other authorities in respect of distribution activity shall not form part of the selling and Distribution Overhead.

(3) Accounts Receivable Ageing Analysis is a periodic report that categorizes a company's accounts receivables according to the length of the time an invoice has been outstanding. It is used as a gauge to determine the financial health of a company's customers. If an account receivables ageing demonstrates that a company receivables are being collected much slower than normal, this is a warning sign that business may be slowing down or that the company is taking greater credit risks in its sales practices.

(4) A corporate development audit is an independent objective study of an organization's capabilities. It aims at identifying strengths and weaknesses and moving toward state-of-the-art performance.

A Corporate Development Audit gives a comprehensive picture of the status of corporate development effectiveness and highlights developmental needs.

Many organizations use the corporate development audit to identify the state-of-the-art in business development in their industry and determine exactly how much they differ from that ideal. The resulting feedback report highlights all key findings, with specific recommendations for course correction or improvement.

Corporate development audit is a comprehensive task to assist the corporate management in various aspects of development through a process of systematic review and evaluation of long-term strategies of the company.

(5) Remuneration of the Cost Auditor:
For the purpose of sub-section (3) of section 148-
(a) In the case of companies which are required to constitute an Audit Committee –
(b) The Board shall appoint an individual, who is a cost accountant in practice, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit Committee, which shall also recommend remuneration for such Cost Auditor;
(c) The remuneration recommended by the audit committee under (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;
(d) In the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant in (i) practice or a firm of cost accountants in practice as cost auditor and remuneration of such cost auditor shall be ratified by the shareholders subsequently.

(6) Details of related Party Transaction are required to be provided in respect of each Related Party and each Product/Service for the year as a whole and not transaction-wise.

(7) Cost Accounting Standards-7 (Para-5.4) deals with separation costs of employees due to some restructuring in the organization. The separation costs related to voluntary retirement, retrenchment termination etc shall be amortized over the period benefitting

from such costs. The amortized separation costs for the period shall be treated as indirect cost and assigned to cost objects in an appropriate manner. However, unamortized amount related to discontinued operations shall not be treated as employee cost.

(8) The turnover of the company (Shanhita Ltd) for the year 2016-17 as per the Companies (Cost Records and Audit) Rules, 2014 is calculated as follows:-

	(Amount in ₹ lakhs)	
Sales: Manufactured products	43,750	
Traded products	2,830	
Income from job works	780	
Sale of Defectives	130	
Exports incentives	85	47,575
Less: Excise Duty		2,840
Turnover		44,735

(9) The Cost Accounting Standard on Packing Material Cost (CAS 9) defines Packing Materials as materials used to hold, identify, describe, store, protect, display, transport, promote and make the product marketable.

Packing Materials for the purpose of the standard are classified into primary and secondary packing materials. Primary Packing Material is that packing material which is essential to hold and preserve the product for its use by the customer. Secondary Packing Material is that packing material that enables to store, transport, inform the customer, promote and otherwise make the product marketable. For example, in 'pharmaceutical industry', cartons used for holding strips of tablets and card board boxes used for holding cartons.

Packing material costs shall be directly traced to a cost object to the extent it is economically feasible. Where the packing material costs are not directly traceable to the cost object, these may be assigned on the basis of quantity consumed or similar measures like technical estimates. The packing material cost of reusable packing shall be assigned to the cost object taking into account the number of times or the period over which it is expected to be reused. Cost of primary packing materials shall form part of the cost of production. Cost of secondary packing materials shall form part of distribution overheads.

(10)XBRL (eXtensive Business Reporting Language) is a Language based on XML (eXtensible Markup Language) family of Languages. It is an open Standards–based reporting system that is built to accommodate the electronic preparation and exchange of business reports around the world using internet as a Medium. It has been defined specifically to meet the requirements of Business and Financial information. It enables unique identifying tags to be applied to items of accounting data. The tags provide a range of information about the item such as whether it is a monetary item, percentage or fraction. XBRL not only allows labels in any language to be applied to items, it also allow the accounting references or other subsidiary information to be added to the tags.