COST & MANAGEMENT AUDIT

Group - IV
Paper - XIX

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

(Statutory body under an Act of Parliament)

www.icmai.in

SYLLABUS - 2016

WORK BOOK

COST AND MANAGEMENT AUDIT

FINAL

GROUP – IV

PAPER – 19

The Institute of Cost Accountants of India

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Preface

Professional education systems around the world are experiencing great change brought about by the global demand. Towards this end, we feel, it is our duty to make our students fully aware about their curriculum and to make them more efficient.

Although it might be easy to think of the habits as a set of behaviours that we want students to have so that we can get on with the curriculum that we need to cover. It becomes apparent that we need to provide specific opportunities for students to practice the habits. Habits are formed only through continuous practice. And to practice the habits, our curriculum, instruction, and assessments must provide generative, rich, and provocative opportunities for using them.

The main purpose of this volume is to disseminate knowledge and motivate our students to perform better, as we are overwhelmed by their response after publication of the first edition. Thus, we are delighted to inform our students about the **e-distribution of the third edition of our 'Work book'.**

This book has been written to meet the needs of students as it offers the practising format that will appeal to the students to read smoothly. Each chapter includes unique features to aid in developing a deeper under-standing of the chapter contents for the readers. The unique features provide a consistent reading path throughout the book, making readers more efficient to reach their goal.

Discussing each chapter with illustrations integrate the key components of the subjects. In the third edition, we expanded the coverage in some areas and condensed others.

It is our hope and expectation that this second edition of work book will provide further an effective learning experience to the students like the first edition.

The Directorate of Studies,

The Institute of Cost Accountants of India

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Suggested Marks Distribution from Examination Point of View

Only for Practice Purpose

Total 100 Marks	3 Hours	MCQ = 20 Marks
		Others = 80 Marks

Objective Question

20 Marks (2 Marks each questions)	MCQ	1 mark for correct answer
		1 mark for justification

Short Notes / Case Study

Minimum Marks for each Questions	3 Marks
Maximum Marks for each Questions	10 Marks

Practical Problem

Minimum Marks for each Questions	4 Marks
Maximum Marks for each Questions	16 Marks

Study Note – 1

BASIS OF COST AND MANAGEMENT AUDIT

Learning Objective: *This chapter helps to know about basis of Cost Audit. Cost Audit represents the verification of cost accounts and check on the adherence to cost accounting plan and also ascertain the accuracy of cost accounting records to ensure that they are in conformity with Cost Accounting principles, plans, procedures and objective.*

1. Choose the correct option among four alternative answer and justify your answer:

(i) ________empowers the Central Government to specify audit of items of cost in respect of certain companies.

(a) Section 128 of Companies Act, 2013

(b) Cost Records & Audit Rules, 2014

(c) Section 148 of Companies Act, 2013

(d) Section 147 of Companies Act,2013

(ii) Cost Audit represents true and faire view of the________of any product.

(a) Cost of sale

(b) Cost of raw material consumption

(c) Cost of production

(d) None of these

(iii) The cost auditor of the company who is in default shall be punishable in the manner as provided in________.

(a) Section 139 of Companies Act, 2013

(b) Sub-sections (1) to (3) of section 148 of Companies Act, 2013

(c) Section 143 of Companies Act, 2013

(d) Sub-sections (2) to (5) of section 147 of Companies Act, 2013

(iv) Cost Records are maintained on________basis.

(a) Accrual

(b) Cash

(c) Actual

(d) None of these.

(v) Item appearing only in Cost Records is________.

(a) Profit on Sale of Assets

(b) Interest Received

(c) Loss on Sale of Assets

(d) Notional Interest on Capital

(vi) Costing includes product, process, and resource-related information covering the_____of the organization and its value chain.

(a) Performance

(b) Ability

(c) Consistency

(d) Functions

(vii) Cost Audit was initially introduced in the year —

(a) 1959.

(b) 1965.

(c) 1949.

(d) 1975.

(viii) Costing is an important tool in________organizational performance in terms of share holder and stakeholder value.

(a) Determining

(b) Calculating

(c) Assessing

(d) None of these

(ix) A company shall within________days from the date of receipt of the Cost audit report shall furnish the same to the Central Government.

(a) 7

(b) 15

(c) 30

(d) 90

(x) The Institute of Cost and Works Accountants of India (ICWAI) was renamed as "The Institute of Cost Accountants of India"

(a) 1959

(b) 1965

(c) 2012

(d) 2011

Answer:

1.

(i) (c) Section 148 of Companies Act, 2013

(ii) (c) Cost of Production

(iii) (d) sub-section (2) to (5) of section 147 of Companies Act, 2013

(iv) (a) Accrual

(v) (d) Notional interest on capital. - This does not involve actual outlay of funds but is included in cost records as an opportunity cost to determine product cost. The other three items are not related to actual production and this do not form part of cost records.

(vi) (d) Functions

(vii) (b) 1965, under Section 233B of Companies Act 1956

(viii) (c) Assessing

(ix) (c) 30

(x) (c) 2012

2. (a) What is the essence of Cost accounting standards?

(b) What are the objectives of Cost Audit?

Answer:

(a) Converting the commonly accepted practices, procedures and requirements into a document is called "Cost Accounting Standard".

Further Practices, procedures and principles relating to cost accounting are covered in the Cost Accounting Standards. The following are the essence of Cost accounting standards:

- It Provide a structured approach to measurement of costs in manufacturing process or service industry.
- Enable practicing members to make use of Cost Accounting Standards in the attestation of General Purpose Cost Statements.
- Integrate, harmonize, and standardize cost accounting principles and practices.
- Provide guidance to users to achieve uniformity and consistency in classification, measurement, assignment, and allocation of costs to products or services
- Assist in clear and uniform understanding of all the related issues of various user organizations, government bodies, regulators, research agencies and academic institutions.
- Arrive at the basis of computing the cost of product, activity, or service where required by legal or regulatory bodies;

(b) Cost Audit has both general and social objectives. The general objectives can be described to include the following:

General Objectives:

- Verification of cost accounts with a view to ascertaining that these have been properly maintained and compiled according to the cost accounting system followed by the enterprise.
- Ensuring that prescribed procedures of the cost accounting records rules are duly adhered to.
- Detection of errors and fraud.
- Verification of the cost of each "cost unit" and "cost center" to ensure that these have been properly ascertained.

- Determination of inventory valuation.
- Facilitating the fixation of prices of goods and services.
- Periodical reconciliation between cost accounts and financial accounts.
- Ensuring optimum utilization of human, physical and financial resources of the enterprise.
- Detection and correction of abnormal loss of material and time
- Inculcation of cost consciousness.
- Advising management, on the basis of inter-firm comparison of cost records, as regards the areas where performance calls for improvement.
- Promoting corporate governance through various operational disclosures to the directors.

Socials Objectives:

- To see whether the pricing of the products are justified as per the product and quality are concerned,
- To remove the disparities, if any, in the pricing of products and/or services.
- To look into that no cost based economic imbalance may occur in product and /or services.
- To facilitate in the global market cost competitiveness of the products.

3. (a) How cost information helps the organization and Management?

(b) What is the Genesis of Cost audit

Answer:

(a)

1. Cost information enables the organization to structure the cost, understand it and use it for communicating withstakeholders
2. Costing is an important tool in assessing organizational performance in terms of Shareholder and stakeholder value. It informs how profit and value are created, and how efficiently and effectively operational processes transform input into output. It contributes to the data input on economy level parameters like resources efficiency, waste management, resources allocation policies etc.
3. Costing includes product, process, and resource-related information covering the functions of the organization and its value chain. Costing information can be used to appraise actual performance in the context of implemented strategies.
4. Good practice in costing should support a range of both regular and non- routine decisions when designing products and services to :
   - Meet customer expectations and profitability targets;

- Assist in continuous improvements in resources utilization; and
- Guide product mix and investment decisions.

5. Working from a common data source (or a single set of sources) also helps to ensure that output reports for different audiences are reconcilable with each other.
6. Integrating databases and information systems can help to provide useful costing information more efficiently as well as reducing source data manipulation.

(b) In the mid-fifties, famous case of corporate frauds in Dalmia-Jain companies virtually jolted the then Government. It resulted in the Government appointing Vivian Bose Commission and later the Dutta Commission and Daphtary- Sastri Committee. These Commissions/ Committees observed inadequacies in the then existing system of financial accounting and audit and also in the then existing system of corporate disclosures. They recommended a more effective system of cost accounting and cost audit, to supplement the financial accounting and auditing practices. Further, in the initial phase of industrial development of the country, there was an acute shortage of goods & materials, as well as, majority of inputs and resources for the production/manufacture of various capital & consumer goods. In the face of scarcity and shortage of almost all the inputs, products and services, Government had to resort to a policy of permits and licensing. A mechanism of Cost audit and maintenance of structured cost data were considered as important instruments in the hands of the regulatory authorities to monitor, control and regulate the efficient use of scarce resources and inputs so made available and monitor cost of production and administer prices. Thus, Cost Audit as a unique feature of corporate management in India, emerged.

Study Note – 2

COMPANIES (COST RECORDS AND AUDIT) RULES, 2014

Learning Objective: ***The Central Government issued Companies (Cost Records and Audit) Rules, 2014 on June 30, 2014. Subsequently, it issued Companies (Cost Records and Audit) Amendment Rules, where certain changes to the original Rules issued on June 30, 2014. The Companies (Cost Records and Audit) Rules, 2014 read with the Amendment Rules 2014 are now applicable and governs the maintenance of cost accounting records and cost audit as per Section 148 of the Companies Act, 2013; This chapter discusses all those mentioned.***

1. Choose the correct option among four alternative answer and justify your answer:

(i) The applicability of cost audit under CCRA – Rules, 2014 for regulated industries having overall annual turnover during immediate preceding financial year

(a) ₹ 25.00 crores or more

(b) ₹ 35 .00 crores

(c) ₹ 50.00 crores or more

(d) ₹ 100.00 crores

(ii) The Company has to upload CRA-4 electronically to the MCA under________of Companies (Cost Records & Audit) Rules, 2014

(a) Rule 5 (1)

(b) Rule 6 (2)

(c) Rule 4 (6)

(d) Rule 6 (6)

(iii) The form in which the cost records shall be maintained .

(a) CRA-1

(b) CRA-2

(c) CRA-3

(d) CRA-4

(iv) Which of the following type of Electricity company is under the purview of regulated sector?

(a) Engaged in Generation

(b) Engaged in Transmission

(c) Engaged in Distribution & Supply

(d) All the above

(v) The Cost Audit Report under CCRA – Rules, 2014 is to be submitted by Cost Auditor in _______ .

(a) CRA-1

(b) CRA-2

(c) CRA-3

(d) CRA-4

(vi) The applicability of cost audit under CCRA – Rules, 2014 for non-regulated industries having _______turnover of individual products or services.

(a) ₹ 25.00 crores

(b) ₹ 35 .00 crores

(c) ₹ 50.00 crores

(d) ₹ 100.00 crores

(vii) Which one of the below is not a regulated industry

(a) Telecommunication

(b) Electricity

(c) Drugs & Pharma

(d) Automobile

(viii) Any casual vacancy in the office of a cost auditor, whether due to resignation, death or removal to be filled by the Board of Directors within_______days of occurrence of such vacancy.

(a) 30 days

(b) 60 days

(c) 90 days

(d) 180 days

(ix) Which of the following statement is not part of Annexure-D of Cost Audit Report?

(a) Product & Profitability Statement

(b) Related Party Transactions

(c) Profit Reconciliation

d) Abridged cost statement

(x) Every cost auditor shall forward his duly signed report to the Board of Directors of the company within a period of _______ days from the closure of the financial year to which the report relates.

(a) 60 days

(b) 90 days

(c) 180 days

(d) 270 days

Answer:

(i) (c) ₹ 50.00 Crore

As per Rule 4 of Companies (Cost Records & Audit) Rules, 2014.

(ii) (d) Rule 6 (6)

Company will file CRA- 4 with the Central Government/ MCA under rule 6 (6) of Companies (Cost Records & Audit) Rules, 2014.

(iii) (a) CRA-1

The form CRA-1 prescribes the form in which cost records shall be maintained. The form categorizes the requirement of maintaining proper details as per 30 headings. The headings are 1. Material Cost, 2. Employee Cost, 3. Utilities etc.

(iv) (d) All the Above

As Regulated Sector defined under Companies (Cost Records & Audit) Rules, 2014.

(v) (c) CRA-3

Every cost auditor, who conducts an audit of the cost records of a company, shall submit the cost audit report along with his or its reservations or qualifications or observations or suggestions, if any, in form CRA-3.

(vi) (b) ₹ 35.00 crore

The applicability of cost audit under CCRA – Rules, 2014 for non-regulated industries having individual turnover of product or services₹ 35.00 croresormore.

(vii) (c) Automobile

Automobile industry is a non-regulated industry under rule 4 of CCRA – Rules, 2014.

(viii) (a) 30 days

As per Rule-6 of the Companies (Cost Records and Audit) Rules, 2014, Any casual vacancy in the office of a cost auditor, whether due to resignation, death or removal to be filled by the Board of Directors within thirty days of occurrence of such vacancy and the company shall inform the Central Government in Form CRA-2 within thirty days of such appointment of cost auditor.

(ix) (d) Abridge cost statement

As per CRA-3, "Abridge Cost Statement" is under Part-C of Annexure to Cost audit report.

(x) (c) 180 days

Every cost auditor shall forward his duly signed report to the Board of Directors of the company within a period of one hundred and eighty days from the closure of the financial year to which the report relates and the Board of Directors shall consider and examine such report, particularly any reservation or qualification contained therein.

2. (a) Discuss about the application of Cost Records?

(b) Write any 5 disqualifications relating to appointment of cost auditor.

Answer:

(a) Application of cost record:

As per sub-section (1) of Section 148 of the Act, the class of companies, including foreign companies defined in clause (42) of Section 2 of the Act, engaged in the production of the goods or providing services, specified in the Rule-3 of Companies (Cost Records & Audit) Rules, 2014 have to maintain the cost records.

As per Rule-3, there has been two categories (i.e. Regulated sectors and Non- regulated sectors) and a general threshold limit of turnover of ₹ 35.00 or more during the immediately preceding financial year has been prescribed for companies. Micro enterprise or small enterprise as per MSMED Act, 2006 have been taken out of the purview.

(b) The following persons are not eligible for appointment as a cost auditor:

(i) A body corporate

(ii) An officer or employee of the company.

(iii) A person who is a partner, or who is in the employment, of an officer or employee of the company.

(iv) A person who is indebted to the company or its subsidiary, or its holding or associate company or a subsidiary or such holding company, for an amount exceeding ₹ 5 lakhs.

(v) A person or a firm who, whether directly or indirectly, has business relationship with the company, its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company.

3. (a) Is a cost auditor required to audit and certify monthly, quarterly, half-yearly and yearly cost statements?

(b) What is the procedure for appointment of cost auditor under the Companies Act, 2013?

Answer:

(a) As per Rule 5, every company under these rules including all units and branches thereof are required, in respect of each of its financial year, to maintain cost records in form CRA-1. The cost records are required to be maintained on regular basis in such manner so as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis. The cost auditor is appointed to conduct audit of the cost records and make report thereon for the financial year for which he is appointed. It is not incumbent upon the cost auditor to certify monthly, quarterly, half-yearly cost statements.

(b) The cost auditor is to be appointed by the Board of Directors on the recommendation of the Audit Committee, where the company is required to have an Audit Committee. The cost auditor proposed to be appointed is required to give a letter of consent to the Board of Directors. The company shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of thirty days of the Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in form CRA-2, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014. Any casual vacancy in the office of a cost auditor, whether due to resignation, death or removal, shall be filled by the Board of Directors within thirty days of occurrence of such vacancy and the company shall inform the Central Government in Form CRA-2 within thirty days of such appointment of cost auditor.

4. (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) A company has units in SEZ and in non-SEZ areas. The Companies (Cost Records and Audit) Rules 2014 has exempted companies operating in special economic zones from cost audit. What would be applicability of the Companies (Cost Records and Audit) Rules 2014 on such a company in respect of maintenance of cost accounting records and cost audit?

(c) The Cost Accountant of KRISHNA MILLS LTD. has arrived at a Profit of ₹ 24,64,000 based on Cost Accounting Records for the year ended March 31, 2019. Profit as per Financial Accounts is ₹32,14,100. As a Cost Auditor, you find the following differences between the Financial Accounts and Cost Accounts:

Sl. No.	Particulars	Value in ₹
1.	Profit on Sale of Fixed Assets	2,05,000
2.	Loss on Sale of Investments	33,600
3.	Voluntary Retirement Compensation included in Salary & Wages in F/A	40,25,000
4.	Donation Paid	75,000
5.	Insurance Claim relating to previous year received during the year	5,08,700
6.	Profit from Retail trading activity	32,02,430
7.	Interest Income from Inter-Corporate Deposits	1,61,500
8.	Decrease in value of Closing WIP and Finished goods inventory	
	as per Financial Accounts	3,82,06,430
	as per Cost Accounts	3,90,12,500

You are required to prepare a Reconciliation Statement between the two Accounts for the year ended March 31, 2019.

Answer:

(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) Rule 3 of the Companies (Cost Records and Audit) Rules 2014 is specific and it has mandated maintenance of cost accounting records on all products/activities listed under Table-A and Table-B subject to threshold limits. No exemption is available to any company from maintenance of cost accounting records once it meets the threshold limits. Hence, the above company would be required to maintain cost accounting records for all its units including the one located in the special economic zone.

In view of the provisions of Rule 4(3)(ii) of the Companies (Cost Records and Audit) Rules 2014 the unit located in the special economic zone would be outside the purview of cost audit and the company would not be required to include particulars of such unit in its cost audit report. The other units of the company located outside the special economic zone would be covered under cost audit subject to the prescribed threshold limits.

(c) Reconciliation of Profit **between Cost and Financial Accounts for the year ended March 31, 2019**

Particulars	**Amount (₹)**	**Amount (₹)**
Profit as per Financial Accounts		**32,14,100**
Add: Lossonsale of investments	33,600	
Add: Voluntary Retirement compensation included in salary	40,25,000	
and wages in F/A - Not included in cost A/c		
Add: Donation paid	75,000	41,33,600
		73,47,700
Less: Profit on Sale of Fixed Assets-Not considered in cost A/c	2,05,000	
Less: Receipts of insurance claim related to previous year	5,08,700	
Less: Profit from Retail trading activity	32,02,430	
Less: Interest income from inter-corporate deposit- not considered in cost accounts	1,61,500	
Less: Difference in valuation of stock:	8,06,070	
(3,90,12,500 - 3,82,06,430)		**48,83,700**
Profit as per Cost Accounts		**24,64,000**

Study Note – 3

COST AUDIT DOCUMENTATION AND AUDIT PROCESS

Learning Objective: ***This chapter discusses about how in documenting the nature and extent of audit procedures performed, the Cost Auditor shall record the characteristics of the specific items or matters tested the responsibility for performing and reviewing such procedures and the relevant dates. The Cost Auditor shall prepare audit documentation that is sufficient to enable another Cost Auditor undertaking a peer review to understanding.***

1. Choose the correct option among four alternative answer and justify your answer:

(i) What is the first stage of an audit of cost statement?

(a) Planning

(b) Performing

(c) Reporting

(d) None of the above.

(ii) What is the final stage of an audit of cost statement?

(a) Planning

(b) Performing

(c) Reporting

(d) None of the above.

Answer:

(i) (a) Planning

Planning is the first stage of an audit. The planning stage involves determining the audit strategy as well as identifying the nature and the timing of the procedures to be performed.

(ii) (c) Reporting

Reporting is the final stage of an audit. The auditor's opinion is expressed in the audit report. The final stage of the audit involves drawing conclusions based on the evidence gathered and arriving at an opinion regarding the fair presentation of cost statements.

2. (a) Discuss about the contents of Cost Audit Documentation.

(b) What do you mean by Audit File?

Answer:

(a) The Cost Audit documentation will usually contain:

(i) Check lists i.e. Checklist of compliance with:-

(1) The Rules, regarding maintenance of Cost Records, as prescribed under the Companies Act,

(2) The Cost Accounting Standards (CAS) as prescribed by the Institute

(3) The Generally Accepted Cost Accounting Principles (GACAP) as prescribed by the Institute

(ii) Audit programs

(iii) Analysis Cost Audit relies more on analytical review than on substantive testing to establish true and fair view.

(iv) Audit Query List containing a log of audit queries raised and their resolution

(v) Abstracts of significant contracts relating to costs and revenues

(vi) Letters of confirmation

(vii) Letter of Representation from Management Correspondence (including e-mail) concerning significant matters.

(viii) Abstract or copies of the entity's records.

(b) Audit file means one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation which are linked directly or indirectly with the audit process.

The cost auditor shall assemble the audit documentation in an audit file. The final audit file should be completed within a reasonable time after the completion of the audit. After the assembly of the final audit file has completed, the auditor should not delete or discard audit documentation of any nature before the end of its retention period.

3. (a) Write a short note on Audit working papers?

(b) Discuss about the stages of an Audit of cost statement.

Answer:

(a) Audit working papers are the documents which record all audit evidence obtained during audit. Such documents are used to support the audit work done in order to provide assurance that the audit was performed in accordance with the relevant Cost Audit and Assurance Standards.

Auditors retain a set of working papers for each audit engagement for each year. The audit working papers for the current year are referred to as the current working papers. Working papers that are relevant to more than one audit engagement are often kept separately in a file referred to as permanent working papers. The audit working papers (current and permanent) for a client audit engagement are sufficiently detailed to enable another appropriately experienced and competent auditor that is not familiar with the client to obtain an overall understanding of the engagement.

Working papers (or documentation) serve three purposes:

(i) aid in planning and performance of the audit;

(ii) aid in supervision and review of the audit work; and support his opinion.

(b) The stages of an audit of cost statements are

1) Planning
2) Performing and
3) Reporting

1. Planning Stage:

Once the entity's acceptance or continuation decision has been made, the first stage is planning the audit. The planning stage involves:

(i) Understanding the entity and its environment

(ii) Risk identification and Strategy

(iii) Risk and materiality assessment

A well-planned audit will ensure that sufficient appropriate evidence is gathered to minimize risk of material misstatement at the cost statement level.

2. Performing Stage:

The second stage is performance or execution stage of the audit, which involves detailed testing of internal controls, material consumptions, cost accumulation, allocation, apportionment, and absorption. This detailed testing provides the evidence that the cost auditor requires to determine whether the cost statements have been fairly presented. The performing stage involves:

- Execution
- Audit Procedures
- Audit Findings

3. Reporting Stage:

The final stage of the audit involves drawing conclusions based on the evidence gathered and arriving at an opinion regarding the fair presentation of cost statements. The cost auditor's opinion is expressed in the cost audit report. At this stage of the audit, a cost auditor will draw on their understanding of the client, their detailed knowledge of the risks faced by the client, and the conclusions drawn when testing the entity's controls, transactions, cost heads, item of cost and related disclosures. So, the final or reporting stage involves:

- Conclusion
- Reporting.

4. (a) In case of practical audit process, mention the steps to be followed by a cost auditor?

(b) What is meant by Cost Audit Documentation and what is its requirement?

Answer:

(a) In order to conduct practical audit, the following steps are to be followed by a cost auditor:

Step I: Objectives of Audit and Management Outlook i.e. cost optimization or cost reduction, checking parameters of operational efficiency of a unit or any utility or any other function or department, identifying profit making or loss making products, suggesting changed marketing strategies, complete review of business strategies etc.

Step II: Pre-conditions i.e. Objectives of cost audit, Area, nature and scope of audit, Number of cost auditors appointed, the applicable reporting framework, the reporting period, the statutory deadlines etc.

Step III: Understanding the Company's Business i.e. the cost auditor is required to understand the company's business, its corporate structure and various systems followed like Internal Control Systems, Internal Audit System, Accounting Systems & Policies , Cost Accounting System & Policies, Company's MIS system, risk identification & management system, IT policy, IT data security policy etc.

Step IV: Planning the Audit which includes timing and duration of audit period, Level and number of audit personnel to be deployed, audit partner to be deployed, drawing up an overall audit plan and audit strategy, Formulating appropriate audit procedures etc.

Step V: Execution of Audit i.e. Perform the audit checks and procedures as planned, Collect all required audit evidence and validate their relevance, reliability and accuracy, Prepare draft observations & discuss with key management personnel and Prepare final audit report.

Step VI: Audit Documentation i.e. Document audit plan, audit strategy, working papers, draft observations, final report etc. and preserve all documents in a bound folder/file for the prescribed period.

(b) Audit helps to detect errors and frauds and provides suggestions to improve them which intern, help the management to take corrective action. To complete the audit process one need to gather the documents related to audit process. Cost Audit Documentation means the material including working papers prepared by and for, or obtained and retained by the cost auditor in connection with the performance of the audit.

The requirements of Cost Audit Documentation are:

(i) The cost auditor as part of the audit documentation shall record audit procedures performed, relevant audit evidence obtained, and conclusions reached.

(ii) The Cost Auditor shall prepare audit documentation that is sufficient to enable another competent person, having no previous connection with the said audit, including person undertaking peer review to understand:

  (a) Conformance of audit procedures performed with legal and regulatory requirements;

  (b) Conformance to Cost Auditing Standards.

  (c) The results of audit procedures performed

  (d) The audit evidence obtained

  (e) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

(iii) The Cost Auditor shall record the discussions of significant matters with client personnel and outsiders.

(iv) The Cost Auditor shall record any departure from the standard requirement in a Cost Auditing Standard.

(v) In documenting the nature, timing and extent of audit procedures performed, the Cost Auditor shall record the characteristics of the specific items or matters tested, the persons responsible for performing and reviewing such procedures with relevant dates and extent of review.

(vi) The Cost Auditor shall prepare audit documentation on a timely basis.

(vii) If, in exceptional circumstances, Cost Auditor performs any new or additional audit procedures or draws new conclusions, after the date of Cost Audit Report, then he shall document such circumstances and details of such procedures performed.

(viii) The cost auditor shall assemble the audit documentation in an audit file.

Study Note – 4

COST AUDITOR – PROFESSIONAL ETHICS AND RESPONSIBILITIES

Learning Objective: ***This chapter helps to know about the Professional Behaviour of the cost auditor while meeting his responsibilities to clients, third parties, other members of the cost and management accounting profession, staff, employers and the general public.***

1. Choose the correct option among four alternative answer and justify your answer:

(i) Cost auditor to report fraud under______of Companies Act, 2013.

(a) Section 140(12)

(b) Section 148(2)

(c) Section 144(10)

(d) Section 143(12)

(ii) There are ________to the Act clarifies or indicates that the schedules provide an illustrativelistofactsand omissions constituting "professional or other misconduct

(a) two schedules

(b) three schedules

(c) four schedules

(d) five schedules

Answer:

(i) (d) Section 143(12)

The auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government under section 143 (12) of Companies act, 2013.

(ii) (a) Two Schedules

As per section 22 of the Cost and Works Accountants Act, 1959 there are two schedules to the Act clarifies or indicates that the schedules provide an illustrative list of acts and omissions constituting ―professional or other misconduct.

2. (a) As per Section 143 of the Companies Act, 2013 what is the duty of a Cost Auditor to Report Fraud.

(b) Discuss about the punishment for false statement (Section 448 of the Companies Act, 2013).

Answer:

(a) According to Section 143(12) of the Companies Act 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within such time and in such manner as may be prescribed.

Sub-Section 13 specifies that no duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred to in sub-section (12), if it is done in good faith.

Sub-Section 14 makes it clear that he provisions of this section shall mutatis mutandis apply to the cost accountant in practice conducting cost audit under section 148.

According to Sub-Section 15 if any auditor, cost accountant or company secretary in practice do not comply with the provisions of sub-section (12), he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty- five lakh rupees.

Matter relating to fraud is to be reported immediately but not later than 2 days of his knowledge specifying:

- Nature of Fraud with description;
- Approximate amount involved; and
- Parties involved.

Following disclosures to be made in Board's Report:

- Nature of Fraud with description;
- Approximate Amount Involved;
- Parties involved, and
- Remedial action not taken

(b) As per Section 448 of Companies Act, 2013 any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of this Act or the rules made there under, any person makes a statement,—

(i) Which is false in any material particulars, knowing it to be false; or

(ii) Which omits any material fact, knowing it to be material, He/she shall be liable under section 447.

3. (a) Write a short note on Code of Ethics in the field of Cost and Management Accounting.

(b) Discuss about the fundamental principles to be observed by the cost accountants.

Answer:

(a) As professionals in the field of Cost and Management Accounting, the members of the Institute are bound by a code of professional ethics. This code stipulates and binds them to the highest level of care, duty and responsibility to their employers and clients, the public and their fellow professionals.

The objectives of the accountancy profession are to work to the highest standards of professionalism, to attain the highest levels of performance and generally to meet the public interest requirement. These objectives require four basic needs to be met:

(i) Credibility in information and information systems;

(ii) Professionalism identified by employers, clients and other interested parties;

(iii) Quality of service carried out to the highest standards of performance; and of services.

(b) The following fundamental principles should be observed by the cost accountants, to achieve the objectives of the accounting profession:

(a) **Integrity:** A cost accountant should be straightforward and honest in performing his services.

(b) **Objectivity**: A cost accountant should be fair and should not allow prejudice or bias or the influence of others to override objectivity.

(c) **Competence**: A cost accountant must refrain from performing any service which he is not competent to carry out unless proper advice and assistance is obtained to ensure that the service is performed to the satisfaction.

(d) **Confidentiality**: A cost accountant must not disclose information acquired during the course of his engagement and should not use or disclose any such information without proper and specific authority or unless there is a legal or professional right or duty to disclose.

(e) **Professional behavior:** A cost accountant should act in a manner consistent with the good reputation of the profession.

In addition to the fundamental principles above a cost accountant in practice, should be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity, objectivity and independence.

Study Note – 5

OVERVIEW OF COST ACCOUNTING STANDARDS AND GACAP

Learning Objective: ***This chapter helps to know about the conceptual frame work of cost accounting standards. Generally Accepted Cost Accounting Principles (GACAP) contains a summary of the Cost accounting principles currently followed by business entities in India in preparing and presenting cost information in the context of general purpose cost statements for statutory reporting and covered by Cost Audit.***

1. Choose the correct option among four alternative answer and justify your answer:

(i) What is Normal idle capacity?

(a) Installed capacity – Internal factors

(b) Normal capacity - Actual capacity

(c) Abnormal Idle capacity – Normal Capacity

(d) Install capacity – Normal capacity

(ii) CAS-17 deals with ________

(a) Royalty and Technical Knowhow fee.

(b) Material Cost.

(c) Research & Development Cost.

(d) Interest & Financing charges.

(iii) CAS 13 deals with _______

(a) Cost of service cost centre

(b) Captive consumption

(c) Capacity determination

(d) Cost classification.

(iv) Which of the following is not forming part of Employee Cost?

(a) Leave Encashment

(b) Medical benefit cost

(c) Retirement Benefits

(d) Compensation for prior period disputes

(v) CAS-21 deals with _______

(a) Cost of Inventory

(b) Utilities Cost

(c) Pollution Control Cost

(d) Quality Control

(vi) Under the Generally Accepted Cost Accounting Principles, the cost of cane supplied from own farm to the sugar mill is treated as _______

(a) Direct Material Cost

(b) Indirect Material Cost

(c) Production Overhead

(d) Administrative Overhead

(vii) CAS 7 deals with:

(a) Administrative Overhead

(b) Employee Overhead

(c) Selling & Distribution Overhead

(d) Finance Cost

(viii) The foreign exchange component of imported material is converted at the rate on –

(a) Date of Payment

(b) Date of Delivery

(c) Date of Transaction

(d) Date of Use

(ix) CAS 10 deals with:

(a) Direct Expenses

(b) Utilities Cost

(c) Pollution Control Cost

(d) Selling & Distribution Cost

(x) Which of the following is not forming part of Cost of transportation?

(a) Cost of transport

(b) Insurance

(c) Demurrage Charge

(d) Cartage

Answer:

(i) (d) **Installed capacity- Normal capacity**

Capacity which remains idle due to some unavoidable factors of plant.

(ii) (d) **Finance Cost- CAS- 17**

This standard deals with the principles and methods of classification, measurement and assignment of interest and financing charges.

(iii) (a) **Cost of Service cost centre – CAS-13**

This standard deals with the principles and methods of classification, measurement and assignment of Cost of Service Cost Centre, for determination of the Cost of product or service, and the presentation and disclosure in cost statements.

(iv) (d) **Compensation for prior period disputes**

As per GACAP, Compensation paid to employees for the past period on account of any dispute / court orders shall not form part of Employee Cost.

(v) (d) **Quality Control – CAS 21**

The standard deals with the principles and methods of measurement and assignment of Quality Control cost and the presentation and disclosure in cost statement.

(vi) (a) **Direct Material cost** –

As per the GACAP, Direct Materials Cost includes cost of procurement and freight inwards of the materials.

(vii) (b) **Employee Cost – CAS 7**

This standard deals with the principles and methods of classification, measurement and assignment of Employee cost, for determination of the Cost of product or service, and the presentation and disclosure in cost statements.

(viii) (c) **Date of transaction.**

This is as per CAS 6 and GACAP

(ix) (a) **Direct Expense CAS-10**

This standard deals with the principles and methods of classification, measurement and assignment of Direct Expenses, for determination of the cost of product or service, and the presentation and disclosure in cost statements.

(x) (c) **Demurrage**

Cost of Transportation comprises of the cost of freight, cartage, transit insurance and cost of operating fleet and other incidental charges but does not include detention and demurrage charges.

2. Write Short notes on:

(a) Abnormal Cost

(b) VRS

(c) Imputed Cost

Answer:

(a) Abnormal Cost: An unusual or atypical cost whose occurrence is usually irregular and unexpected and / or due to some abnormal situation of the production or operation. Any abnormal cost where it is material and quantifiable will not form part of the cost. Some examples of Abnormal Cost are: Loss on destruction due to fire; lockout; Cost incurred due to shut down of machinery etc.

(b) VRS: The voluntary retirement scheme (VRS) is the most human technique to provide overall reduction in the existing strength of the employees. It is normally deployed when company faces the problem of surplus labour. It is a technique used by companies for trimming the workforce employed in the industrial unit.

(c) Imputed Cost: Imputed costs are notional costs that a firm foregoes by taking one action or strategy over another. if a company uses its own buildings for production, it loses the income from renting it or selling to a third party. As this is not a financial expenditure, the firm does not report it on its financial statements. It is also called as Implicit Cost/ Notional cost which is not involving cash outlay.

3. (a) What is cost centre and what are the types of cost centre?

(b) What is the principle of valuation of receipt of materials as per CAS-6?

Answer:

(a) Any unit of an entity selected with a view to accumulating all cost under that unit. The unit can be division, department, section, group of plant and machinery, group of employees or combination of several units. Cost Centre or Cost Object is the logical sub-unit for collection of cost.

Cost Centre is of two types:-

1. Personal Cost Centre – Refers to Human Resources
2. Impersonal Cost Centre – Refers to all resources other than HR
   (i) Operating Cost Centre
   (ii) Support Service Cost Centre

(i) Operating Cost Centre:

Examples:

1. Medicine Shop
2. Assembly Shop
3. Welding shop
4. Operation theatre
5. Call Centre (BPO)

(ii) Support Service Cost Centre:

Examples:

1. Power House
2. Maintenance
3. Stores
4. Help Desk
5. Transportation for Call Centre Staff

(b) As per CAS-6 the following are the Principles of valuation of receipt of materials:

(i) The material receipt should be valued at purchase price including duties and taxes, freight inwards, insurance, and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited by the taxing authorities) that can be quantified with reasonable accuracy at the time of acquisition.

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

(iii) Normal loss or spoilage of material prior to reaching the factory or at places where the services are provided shall be absorbed in the cost of balance materials net of amounts recoverable from suppliers, insurers, carriers or recoveries from disposal.

(iv) Losses due to shrinkage or evaporation and gain due to elongation or absorption of moisture etc., before the material is received shall be absorbed in material cost to the extent they are normal, with corresponding adjustment in the quantity.

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

Explanation: The date on which a transaction (whether for goods or services) is recognised in accounting in conformity with generally accepted accounting principles.

(vi) Any demurrage or detention charges, or penalty levied by transport or other authorities shall not form part of the cost of materials.

(vii) Subsidy/Grant/Incentive and any such payment received/receivable with respect to any material shall be reduced from cost for ascertainment of the cost of the cost object to which such amounts are related.

4. (a) What are the types of capacity defined as per CAS-2?

(b) How to value the cost of repair and maintenance as per CAS-12 under following circumstances:

(i) In-house R&M activity

(ii) R&M by contractor inside entity

(iii) R&M by contractor in its premises

Answer:

4. (a)

The following are the five types of Capacity which has defined under CAS-2

Types of Capacity:

(a) Installed capacity

(b) Normal Capacity

(c) Actual Capacity Utilization

(d) Normal idle Capacity

(e) Abnormal idle Capacity

(a) Installed capacity

Maximum productive capacity of a plant taking into account the following 5 factors:

1. Manufacturer's specification
2. Individual or Inter-related production or Operation Centre Capacities
3. Operational Constraints
4. No. of shifts
5. Technical evaluation

(b) Normal Capacity

Maximum productive capacity of a plant reduced by internal factors. Internal Factors:

- Time lost or spent on preventive maintenance
- Weekly and paid holidays
- Batch or Set-up delays

Normal Capacity = Installed Capacity – Internal factors

(c) Actual Capacity Utilization

It is the actual production for the year.

(d) Normal Idle Capacity

Difference between Installed Capacity and Normal Capacity

(e) Abnormal Idle Capacity

Difference between Normal Capacity and Actual Capacity

4. (b)

Repairs and maintenance cost shall be the aggregate of direct and indirect cost relating to repairs and maintenance activity.

(i) Cost of in-house repairs and maintenance activity shall include cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources used in such activity.

(ii) Cost of repairs and maintenance 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.

(iii) Cost of repairs and maintenance 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.

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

(b) What disclosures are required to be made in Cost statement as per CAS-16 Answer:

Answer:

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

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

1) Air pollution: Which is the human introduction into the atmosphere of chemicals, particulates or biological materials that cause harm or discomfort to humans or other living organisms or damage the environment,

2) Water pollution: Due to unsanitary way of living, there is the contamination of water bodies. Water pollution affects public health and safety, causes damage to property and leads to many economic losses,

3) Smell pollution: Discharge of human soils openly, unclear garbage dumps, open sewers, etc. Affect physical well-being and even causes psychological disorders.

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

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

- Where estimates are made of future costs to be incurred on pollution control, the basis of estimate shall be disclosed separately.

(b) Disclosures in cost statements as regards to Depreciation & Amortization as per CAS-16 are as follows-:

(i) The basis of distribution of Depreciation and Amortisation to the cost objects.

(ii) Any credits / recoveries relating to Depreciation and Amortisation.

(iii) Additional Depreciation on account of revaluation of asset, which is not included in cost.

(iv) Amount of depreciation that is not included in cost because of temporary retirement of assets from production of goods and services.

Disclosure shall be made only where material, significant and quantifiable. Disclosures shall be made in the body of the cost statement or as a foot note or in a separate schedule. Any change in the cost accounting principles and methods applied for the measurement and assignment of Depreciation and Amortisation during the period covered by the cost statement which has a material effect on Depreciation and Amortisation shall be disclosed. Where the effect of such change is not ascertainable wholly or partly, the fact shall be indicated

6. (a) How you deal with the cost of Indirect materials?

(b) Solve the problem:

M/s JSPL engaged in production of material X. The Standard Material requirement to produce 2,000 units of product X is 2,400 units of material at a standard price of 120 per unit. The Standard allows for reject of 25% of input. It is estimated that one third of rejects can be reworked at an additional cost of ₹40 per unit. Scrap units can be sold at ₹10 per unit.

During a particular period, units produced were 39,000 with 48,000 units of materials at standard cost of ₹120 per unit, 14000 units were rejected out of which 5000 units were reworked at a cost of ₹1,02,000. The balance units were sold as scrap for ₹10 per unit.

The following are other production related cost which are as follows:

i. The factory overhead is 25% of material cost.

ii. Labour cost is ₹5,25,000.

iii. Repair & maintenance cost incurred during the year is ₹ 2,05,000. Calculate Material Cost variance and Actual cost of production.

Answer:

(a) Assignment of costs of indirect materials:

(i) The cost of indirect materials shall be assigned to the various Cost objects based on a suitable basis such as actual usage or technical norms or a similar identifiable measure.

(ii) The cost of materials like catalysts, dies, tools, moulds, patterns etc, which are relatable to production over a period of time shall be amortized over the production units benefited by such cost.

(iii) The cost of indirect material with life exceeding one year shall be included in cost over the useful life of the material.

(b) Quality control cost is the cost of resources used for quality control procedures.

Standard Material Cost:

Particulars	**Details**	**Amount (₹)**
Material 2,400 units	Standard Cost (@120)	2,88,000
Rejection (25%) 600 units		
Reworked Unit (1/3) = 200 units	Rework cost (@40)	8,000
Scrap of 400 units	Sale value of scrap (@10)	-4,000
	Standard Cost of material	2,92,000
Unit Produced 2,000 (2,400 - 400)	Standard Cost per unit	146.00

Actual Material cost: 1

Particulars	**Details**	**Amount (₹)**
Material 48,000 units	Actual Cost (@ 120)	57,60,000
Rejection 14,000 units		
Reworked Unit = 5,000	Rework cost	1,02,000
Scrap of 9,000 units	Sale value of scrap (@ 10)	-90,000
	Actual Cost of material	57,72,000
Unit Produced 39,000 (48,000 – 9,000)	Actual Cost per unit	148.00

As we know, **Material Cost Variance** = Material price variance + Material usage variance

Material Price Variance = Actual Quantity (Standard price- Actual price)

= 39,000(146 – 148) = 78,000 (A)

Material Usage Variance = Standard rate (Actual Quantity - Standard quantity)

= 120 (48,000 – 46,800)

= 120 × 1200 = 1,44,000 (A)

***Workings**

Calculation of Standard in-put for getting 39,000 output:

= (2,400 × 39,000)/2,000 = 46,800

Material Cost Variance = 78,000 (A) + 1,44,000 (A) = 2,22,000 (A)

(i) Calculation of Cost of production:

Particulars	**Amount (₹)**
Material Cost	57,72,000.00
Labour Cost	5,25,000.00
Factory Overhead (25% of Material cost)	14,43,000.00
Repair & Maintenance	2,05,000.00
Cost of Production	**79,45,000.00**

Study Note – 6

OVERVIEW OF COST AUDITING STANDARDS

Learning Objective: *This chapter discusses the Cost Accounting Standards. Cost Accounting Standards are designed to achieve uniformity and consistency in the cost accounting principles and to establish regulations and also to follow the disclosed practices consistently and to comply with promulgated cost accounting standards.*

1. Choose the correct option among four alternative answers and justify your answer:

(i) Cost Auditing Standards first came in force in year_____.

(a) 2013

(b) 2016

(c) 2018

(d) 2015

(ii) Cost auditing standards, preface to the standards on auditing, quality control review and related services rendered by the cost accountant has been issued by______ .

(a) ICAI

(b) ICMAI

(c) CAASB

(d) ICWAI

(iii) The Cost Auditing Standard 102 deals with______ .

(a) Cost Audit Documentation

(b) Planning an audit of Cost Statements

(c) Knowledge of business, its processes and the business

(d) Overall objectives of the independent cost auditor

(iv) Requirements of CAS – 104, the cost auditor shall______ .

- **(a) Comply with the relevant ethical requirements**
- **(b) Have adequate level of understanding of the knowledge of business**
- **(c) Prepare audit documentation**
- **(d) None of the above.**

Answer:

(i) (d) 2015

Government of India, Ministry of Corporate Affairs approves the Cost Auditing Standards 10th September, 2015, which came in to force from 11th September 2015.

(ii) (c) CAASB

While formulating the Standards, the Cost Audit & Assurance Standards Board [CAASB] takes into consideration the applicable laws, usage and business environment prevailing in India. CAASB also takes into account the relevant provisions of Cost and Works Accountants Act, Rules and Regulations, Code of Professional Ethics, Cost Accounting Standards and other Statements issued by the Institute of the Cost Accountants of India.

(iii) (a) Cost Audit Documentation

Cost Auditing Standard 102 This Standard deals with the cost auditor's responsibility to prepare audit documentation for the audit of cost statements, records and other related documents.

(iv) (c) Have adequate level of understanding of the knowledge of business

In performing an audit of cost statement, records and other related documents, the cost auditor should have the knowledge of the client's business to enable him to understand the processes and express his opinion on the cost statements.

2. (a) What is the difference between Cost Accounting Policy and Cost Accounting System?

(b) What is the purpose of Cost audit documentation?

Answer:

(a) 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.

(b) The purpose of the cost audit documentation is to provide guidance to in preparation of Audit Documentation in the context of the audit of cost statements, records and other related documents. It serves a number of additional purposes, which are as following:

(i) Assisting the audit team to plan and perform the cost audit.

(ii) Assisting members of the audit team responsible for supervision to direct and supervise the cost audit work, and to discharge their review responsibilities.

(iii) Enabling the audit team to be accountable for its work.

(iv) Retaining a record of matters of continuing significance to future cost audits.

(v) Enabling the conduct of quality control reviews in accordance with the Guidance Manual for Audit Quality issued by Quality Review Board (QRB).

(vi) Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

4. (a) What are the relevant factors that the cost auditor should consider while formulating overall audit strategy?

(b) What is the objective of Cost Auditing Standard – 102?

Answer:

(a) The Cost Auditor shall formulate an overall audit strategy that sets the scope, timing and direction of the audit. The overall audit strategy guides the development of the audit plan. These relevant factors includes:

(i) Results of preliminary activities

(ii) Knowledge from previous audits and other engagements with the auditee

(iii) Knowledge of business

(iv) Nature and scope of the audit

(v) Statutory deadlines and reporting format

(vi) Relevant factors determining the direction of the audit efforts

(vii) Nature, timing and extent of resources required for the audit.

(b) Cost Auditing Standard – 102 deals with the cost auditor‘s responsibility to prepare audit documentation for the audit of cost statements, records and other related documents. The specific documentation requirements of other Cost Auditing Standard‘s do not limit the application of this Cost Auditing Standard. Laws or regulations may establish additional documentation requirements.

The objective of this Standard is to guide the members to prepare documentation that provides:

(a) A sufficient and appropriate record of the basis for the Cost Auditor‘s Report; and

(b) Evidence that the audit was planned and performed in accordance with Cost Auditing Standards and applicable legal & regulatory requirements.

5. (a) What enables the cost auditor for having good knowledge of client's business, it's process & environment as per Cost auditing standard 104?

(b) Discuss about the requirements of Cost Auditing Standard – 103.

Answer:

(a) The Cost Auditor shall have adequate level of understanding of the knowledge of Business, its Processes and the Business Environment to develop a reasonable assurance in order to express an opinion on the cost statements on which he is expressing an opinion. The following are some broad areas where the cost auditor need to focus for the better understanding of client's business:

(i) **The Entity and Its Environment:** The cost auditor should obtain an understanding of the following:

(a) The nature of the entity, (including its operations covering Business processes, major inputs, Joint & By- Products and Wastages and major outputs etc) and the entity's ownership and governance structure.

(b) Relevant industry, regulatory, and other external factors including the applicable cost and financial reporting framework.

(c) The entity's selection and application of cost accounting policies.

(d) The measurement and review of the entity's performance.

(ii) **The Entity's Internal Control:** The cost auditor shall obtain an understanding of internal controls relevant to the audit.

(a) Control Environment: The cost auditor shall evaluate whether management has created and maintained a culture of honesty and ethical behaviour.

(b) The entity's risk assessment process: The cost auditor shall obtain an understanding of whether the entity has a process for:

(1) Identifying business risks relevant to cost reporting objectives;

(2) Assessing the likelihood of their occurrence;

(3) Estimating the significance of the risks; and

(4) Deciding about actions to address those risks.

(iii) **Cost Information System/ Management Information System:** The cost auditor shall obtain an understanding of the Information System including Management Information System, relevant to cost reporting, including the following areas:

(1) The classes of transactions and their analysis, that are significant to the cost statements;

(2) The procedures, by which those transactions and their analysis are initiated, recorded, processed, and reported in the management information systems and cost statements;

(3) The related cost accounting records, supporting information that are used to initiate, record, process and report transactions; and

(4) The reporting process used to prepare the entity's cost statements, including significant estimates and disclosures.

(iv) **Control Activities:** The auditor shall obtain an understanding of the control activities, relevant to the audit.

(v) **Monitoring of controls:**

(1) The auditor shall obtain an understanding of the major activities, that the entity uses to monitor internal control over reporting.

(2) The cost auditor shall evaluate the adequacy of the internal audit function in relation to cost records.

(b) The Cost Auditing Standard – 103 deals with the overall objectives of the independent cost auditor, the nature and scope of a cost audit, the independent auditor's overall responsibilities when conducting an audit of cost statements in accordance with Cost Auditing Standards. It also explains the requirements establishing the general responsibilities of the independent auditor applicable in all audits, including the obligation to comply with the Cost Auditing Standards.

The requirements of Cost Auditing Standard – 103 are given below:

(a) The cost auditor shall comply with the relevant ethical requirements including those pertaining to independence in respect of cost audit engagements.

(b) While conducting an audit, the cost auditor shall comply with each of the Cost Auditing Standards relevant to the audit.

(c) The cost auditor shall have an understanding of the entire text of the Cost Auditing Standard, including its application and other explanatory material, to understand its objectives and to apply its requirements properly.

(d) The cost auditor shall plan and perform an audit with an attitude of professional skepticism recognizing that circumstances may exist that cause the Cost Statements to be materially misstated.

(e) The auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion.

(f) The cost auditor shall determine whether the Cost Reporting Framework followed by management in preparing cost statements is in line with the Companies Act and the Rules prescribed there under.

(g) The cost auditor shall not be required to perform audit procedures regarding the entity's compliance with laws and regulations governing cost audit in the absence of identified or suspected non-compliance.

(h) If an objective in a relevant Cost Auditing Standard cannot be achieved, the auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and thereby requires the auditor, in accordance with the Cost Auditing Standards, to modify the auditor's opinion.

6. Write short notes on:

a. Risk assessment

b. Risk of Material misstatement

c. Audit and Ethics

Answer:

(a) Risk assessment:

The audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the overall cost statement level and at the assertion level including items of cost, cost heads and the cost auditor shall obtain an understanding of whether the entity has a process for:

(1) Identifying business risks relevant to cost reporting objectives;

(2) Assessing the likelihood of their occurrence;

(3) Estimating the significance of the risks; and

(4) Deciding about actions to address those risks

(b) Risk of material misstatement:

Audit risk is a function of the risk of material misstatement and detection risk. The risk of material misstatement has two components viz. Inherent Risk and Control risk.

(1) **Inherent risk:** the susceptibility of an assertion about the measurement, assignment or disclosure of cost to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

(2) **Control risk:** the risk that a misstatement that could occur in an assertion about the measurement, assignment or disclosure of cost and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entities internal, operational and management control.

The cost auditor shall identify and assess the risks of material misstatement at the cost statement level; and at the assertion level including items of cost, cost heads and disclosures thereof.

(c) Audit and Ethics:

The cost auditor should comply with relevant ethical requirements as per Code of Ethics issued by the Institute of Cost Accountants of India. This code establishes fundamental principles of professional ethics relevant to the auditor while conducting an audit and provides a conceptual framework for applying these principles. The fundamental principles with which the auditor is required to comply are Independence, Integrity, Objectivity, Professional competence and due care, Confidentiality and Professional conduct. In case of an audit engagement, it is in the public interest that the auditor should be independent of the entity subject to the audit. The cost auditor's independence from the entity safeguards the cost auditor's ability to form an opinion without being affected by influences that might compromise that opinion. Independence enhances the auditor's ability to act with integrity to be objective and to maintain an attitude of professional scepticism.

Study Note – 7

FILING OF COST AUDIT REPORT TO MCA
[In XBRL format (as per Taxonomy)]

Learning Objective: ***Every Cost Auditor or every Lead Cost Auditor on behalf of all the Cost Auditors in a Company, has to file their Cost Audit Report and other documents with the Central Government as per sub-section (4) of section 233B of the Act, and rules made there under. Companies operating in the above mentioned industries and meeting the criteria, should have cost auditors to conduct their cost records and file in XBRL format and those are discussed in the chapter.***

1. Choose the correct option among four alternative answers and justify your answer:

(i) Comprehensive definitions and accurate data tags of XBRL allows for:

(a) Preparation

(b) Consumption

(c) Analysis

(d) All of the above

(ii) 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

(iii) Within a period of _______ days, company shall file acopy of the cost audit report to the Central Government.

(a) 30 days

(b) 45 days

(c) 60 days

(d) 90 days

(iv) The length of Service Request Number (SRN) is ______.

(a) 8

(b) 9

(c) 10

(d) 11

(v) ______ of the Annexure to the Cost Audit Report of Companies (Cost Records and Audit) Rules, 2014 indicates the details of Quantitative Information.

(a) Part A, Para 1

(b) Part A, Para 2

(c) Part A, Para 3

(d) Part A, Para 4

Answer:

(i) **(d)** All of the above

Comprehensive definitions and accurate data tags of XBRL allows for preparation, validation, publication, exchange, consumption and analysis of business information of all kinds.

(ii) **(a)** Mapping.

This is as per XBRL glossary. Several technical terms are used, that have specific meanings, in the contextofusing XBRL.

(iii) **(a)** 30 days

Rule 6(6), of the Companies (Cost Records and Audit) Rules, 2014, as amended by the Companies (Cost Records and Audit) Amendment Rules, 2016, within a period of thirty days, company shall file a copy of the cost audit report to the Central Government.

(iv) **(b)** 9

A Service Request Number (SRN) is nine character alphanumeric strings, which starts with a letter followed by eight numerical numbers. Companies who have filed multiple Form 23C in respect of multiple cost auditors will be required to provide the SRN Numbers against each Form 23C filed.

(v) **(d)** Part A, Para 4

Part-A, Para 4 of the Annexure to the Cost Audit Report of Companies (Cost Records and Audit) Rules, 2014 require reporting of Net Operational Revenue of every CETA Heading separately comprised in the Total Operational Revenue as per Financial Accounts. The quantitative information and abridged cost statements will have to be provided for each unique combination of CETA Heading and UOM of the Products which are covered under cost audit.

2. (a) What is Costing Taxonomy?

(b) What are the steps to be followed to file the Cost Audit Reports in XBRL Format?

Answer:

(a) Costing Taxonomy is a dictionary of all cost elements required in the cost audit report and compliance report. The costing taxonomy contains the properties and interrelationships of all these cost elements for the purposes of capturing the required reporting data in XBRL format.

(b) The following steps are to be followed in sequence to file the Cost Audit Reports in XBRL Format:

(i) Mapping the individual cost elements of the Company to the elements of taxonomy.

(ii) Populating relevant data in the soft ware/ filing tool.

(iii) Creating instance document.

(iv) Validating the instance document with the validation tool of MCA.

(v) Use available tool to convert the instance document to a human readable format and check correctness of data.

(vi) Attaching instance document to the e-form and filing on MCA portal.

3. (a) What are the advantages of XBRL reporting?

(b) How can the cost audit report and compliance report is converted into the XBRL format?

(c) How and who can make the Application of XBRL?

Answer:

(a) XBRL makes reporting more accurate and more efficient. It allows unique tags to be associated with reported facts and allowing:

(i) people publishing reports to do so with confidence that the information contained in them can be consumed and analysed accurately

(ii) people consuming reports to test them against a set of business and logical rules, in order to capture and avoid mistakes at their source

(iii) It helps in saving costs and improving the efficiency in managing business information financial or cost.

(iv) It is useful in exchange of information between different information systems in entirely different organisations. This allows for the exchange of business information across a reporting chain.

(v) people using the information to do so in the way that best suits their needs, including by using different languages, alternative currencies and in their preferred style.

(vi) Comprehensive definitions and accurate data tags of XBRL helpful in preparation, validation, publication, exchange, consumption and analysis of business information of all kinds.

(b) XBRL (Extensible Business Reporting Language) is an open source technology. Any of the following methods can be adopted to create the instance document required for filingof the respective reports.

- XBRL-enabled software packages developed by different software vendors which support the creation of cost reports in XBRL format can be used to create the necessary document.
- Various elements of Cost Audit Report and Compliance Report can be mapped into XBRL tags of the costing taxonomy using specialised XBRL software tools specifically designedforthis purpose.
- Different third party packages can be integrated into the existing accounting systems to generate XBRL Cost statements.
- There are various web based applications available that take input reports in various formatsviz. Microsoft Exceletc. andtransform them into XBRLformat.

The methodology adopted by an individual company will depend on its requirements and the cost accounting software and systems being used and other factors.

(c) All types of organisations can make use of XBRL to automate their process of data collection and distribution to various stakeholders. XBRL-being extensible and flexible, can fulfil a wide variety of requirements. It can be applied to a very wide range of business applications including finance and cost data. XBRL has applications in the following areas:-

(i) Reporting for internal and external purposes by an entity involving finance and costing data/information.

(ii) Business reporting to all types of regulators, including tax and financial authorities, central banks and governments.

(iii) Filing of loan reports and applications; credit risk assessments.

(iv) Exchange of information between government departments, institutions a-: banks.

Study Note – 8

MANAGEMENT REPORTING ISSUES UNDER COST AUDIT

Learning Objective: ***A statement of the company's financial position, such as Capital employed, Net worth, Profit before tax and ratio in terms of value and as percentage for the company sales, operating profit, value addition as a whole and for the product under reference, current ratio, debt-equity ratio, stocks of raw materials, stores & spares, WIP and finished goods in terms of number of months of consumption, production cost and cost of sales and also an analysis of expenditures restated in terms of costs per unit of output are discussed in the chapter under management reporting issues under cost audit.***

1. Choose the correct option among four alternative answers and justify your answer:

(i) Standard Costing is used for the purpose of _______ .

(a) Cost computation

(b) Cost control

(c) Cost minimization

(d) Pricing

(ii) The basic quantitative information on capacity is covered in the _______ of CRA 3 of Cost audit report.

(a) Annexure 3 of Part B and C

(b) Annexure 1 of Part D

(c) Annexure 1 of Part B and C

(d) Annexure 1 of Part A

(iii) KPI can be classified in the following Category _______ .

(a) Quantitative & Qualitative

(b) Actionable

(c) Trending

(d) All of the above

(iv) Target costing is used for the purpose of ______ .

(a) Cost Computation

(b) Cost Reduction

(c) Pricing & Decision making

(d) Cost Control

(v) Balance Scorecard is basically used for the purpose of ______ .

(a) Cost Computation

(b) Cost Reduction

(c) Cost Control

(d) Total performance management

(vi) Life cycle costing is used for the purpose of ______ .

(a) Cost Reduction

(b) Pricing and decision making

(c) Total performance management

(d) Cost Control.

(vii) Kaizen costing is used for the purpose of ______ .

(a) Cost Reduction

(b) Pricing and decision making

(c) Total performance management

(d) Cost Control.

(vii) ______ is a Management accounting tool which is used for cost computation.

(a) Budgetary control

(b) Total quality Management

(c) Activity based costing

(d) Life cycle costing

(ix) What are the Key performance indicators for evaluating "Productivity & Efficiency" of an organisation?

(a) Turnover, Margins & Balance sheet

(b) Complaints, Risks & Development

(c) Material, Machine & Labour

(d) Cost, Quality & Delivery

Answer:

(i) (c) Cost control

Standard costing is a management accounting tool which is used to control cost.

(ii) (c) Annexure 1 of Para B & C

As per form CRA-3 pursuant to rule 6(4) of Companies (Cost Records & Audit) Rules, 2014, the Quantitative information regarding manufacturing sector is specified under Annexure-1 of Para-B while for service sector it is Annexure -1 of para-C.

(iii) (d) All of the above

The KPIs could be:

(i) Quantitative – these can be financial or non-financial

(ii) Qualitative – these are often lead indicators i.e. they influence future performance

(iii) Actionable – those which can be influenced by enterprise actions or controllable

(iv) Trending – those which need to be assessed over a period of time to observe whether they are improving or not.

(iv) (c) Pricing & Decision making

Target costing is a management accounting tool which is used to pricing & decision making by the management.

(v) (d) Total performance management.

Balance scorecard is a management accounting tool which is used to measure total performance of organization.

(vi) (b) Pricing and decision making

Life cycle costing is a management accounting tool which is used for the purpose of pricing and decision making of the organization.

(vii) (a) Cost Reduction

Kaizen costing is a management accounting tool which is used for the purpose of cost reduction of the organization.

(viii) (c) Activity based costing

Activity based costing is one of the management accounting tool which is used by management for cost computation.

(ix) (c) Material, Machine & Labour

Material, Machine & Labour are the Key performance indicator for evaluating the productivity and efficiency of an organisation.

2. (a) What are the basic characteristics an ideal report on performance analysis should have?

(b) State the objective of preparing the Performance Analysis Report.

Answer:

(a) An ideal Report on Performance Analysis should possess the following characteristics:

(i) Objectivity

(ii) Capability of being predictive value

(iii) Comprehensiveness

(iv) No information overload

(v) Coverage of strategic thrust

(vi) Trend measures and current status

(vii) Timeliness

(viii) Segmented and enterprise-wide coverage

(b) The basic objective to prepare a Report on Performance Analysis is to provide an actionable insight into costs and profitability for the management in the strategic and operational context. It aims at discovering various drivers of costs and profitability and their impact on the selected performance variables. It would help the organisations:

(i) to improve profits and profitability

(ii) to optimize resource allocation

(iii) to optimize the product and services portfolio

The objective is to provide assessment of the performance of the organisation across various spectrums. It inter-alia aims at satisfying the goals of management audit. It is concerned with providing the Board with information that it "should know" to take suitable actions to improve business performance.

3. (a) What are the criteria that the management auditor should consider while evaluating the report on performance analysis?

(b) Indicate the contents of Performance Analysis Report?

Answer:

(a) The following criteria may help the management auditor to select and include the various performance measurement criteria in the Report on Performance Analysis:

(i) Effect on profitability

(ii) Effect on resource utilisation

(iii) Effect on liquidity

(iv) Effect on risks

(v) Effect on quality

(vi) Effect on competitiveness

(vii) Effect on responsiveness to the market etc.

(b) The Report on Performance Analysis may cover the following indicative areas:

(i) Capacity Utilization Analysis

(ii) Productivity/Efficiency Analysis

(iii) Utilities/Energy Efficiency Analysis

(iv) Key-Costs & Contribution Analysis

(v) Product/Service Profitability Analysis

(vi) Market/Customer Profitability Analysis

(vii) Working Capital & Inventory Management Analysis

(viii) Manpower Analysis

(ix) Impact of IFRS on the Cost Structure, Cash-Flows and Profitability

(x) Application of Management Accounting Tools

4. (a) Discus the steps suggested for the report on performance analysis?

(b) What is management accounting tools? Give examples of such tools which are used in today's modern business and specify the use of such tools?

Answer:

(a) The below are the suggested steps involved in the preparation of report on Performance Analysis:

(i) Identify and understand the key strategies of the company, both prescriptive and emergent strategies included.

(ii) Choose strategies that have more visible expressions in costs data maintained by the company.

(iii) Identify the activities that were impacted by the strategies selected and also implemented during the year.

(iv) Analyze the cost implications of those activities and link it with the expected results of the strategies.

(v) Present the evaluation, in a table or any other easily comprehensible format like histogram, chart, graph etc.

(vi) Give explanatory notes for the terms used, calculations made, and assumption behind the evaluations.

(vii) Finalize the finding after a discussion with the concerned operating executives and then with the management of the company.

(b) A management accounting tool is a framework, model, technique or process that enables management accountants to: improve performance; facilitate decision- making; support strategic goals and objectives; and otherwise add value.

The management accounting tools could be used to analyse the performance with different purposes. The auditor should verify the tools and techniques used by the company and comment on appropriateness and adequacy thereof. The auditor could recommend more appropriate management accounting tool.

The following table shows various management accounting tools that are used to serve different objectives:

Management Accounting tool	Purpose
Budgetary control, standard costing, variance analysis	Control
Full (absorption) Costing, Job, batch, process or contract costing Activity based costing, Time Driven ABC	Cost computation
Total Quality management, Quality costing, Kaizen costing, Lean manufacturing, Value Analysis and Value Engineering, Six Sigma	Cost reduction
Target costing, Life cycle costing, Throughput accounting, Variable or marginal costing	Pricing and decision making
Balanced Scorecard, Performance Prism, Performance pyramid, Business Objects, Business Intelligence	Total performance management

5. Write short notes on:

(a) Capacity Utilisation analysis

(b) Key Performance Indicators (KPIs)

Answer:

(a) Capacity Utilisation analysis

(i) The basic quantitative information on capacity is covered under Cost audit report in the Annexure 1 of Part B of CRA 3 if the organisation is involved in manufacturing activities or Annexure 1 of Part C of CRA 3 if the organisation is rendering services. However, this information is only indicative and does not provide analytical review. Capacity is usually expressed in terms of the final cost unit and where not so possible in terms of machine hours, people hours etc.

(ii) The concept of capacity is highly subjective. The auditor should assess this impact by analysing and relating the impact of capacity costs on profitability.

(iii) The auditor should collect information of theoretical capacity, practical capacity, normal capacity and budgeted capacity for the period under review.

(iv) The auditor should assess various capacity limits for better analysis and reporting. All these have costs and could affect profitability. These are:

- Internal physical capacity – machinery & equipment
- External physical capacity – subcontracting and leasing
- The capacity of manpower bandwidth at all levels
- The financial capacity

(v) When comparing the actual production with the capacity, the auditor should identify and analyse the reasons for variation due to controllable and uncontrollable causes. It would help to concentrate on material impact caused due to idle time, break-downs, lack of power, lack of material, lack of demand. It would be advisable to compute the cost impact of these.

(vi) Most of the capacity related information is available with the production and industrial engineering departments. The auditor should also refer to the GST records for actual production data.

(vii) The auditor should comment on how the company responds to the variations in product demand by adjusting its capacity. This should be done with respect the cost impact.

(b) Key Performance Indicators (KPIs)

Key Performance Indicators (KPIs) are simply the variables, independent or interdependent, in respect of which the goals can be set and performance measured to assess whether it is in furtherance of the enterprise objectives. Hence, for evaluation of performance the selection of KPIs must be chosen correctly in tune with the objectives. The KPI measurement should not be a static computation, but always needs to be compared with a benchmark set. The KPIs could be:

- Quantitative – these can be financial or non-financial
- Qualitative – these are often lead indicators i.e. they influence future performance
- Actionable – those which can be influenced by enterprise actions or controllable
- Trending – those which need to be assessed over a period of time to observe whether they are improving or not.

6. Problem on performance analysis:

Profit and Loss Account and Balance sheet of ABC Ltd. for the year ending 31.03.2019 is given below:

Balance Sheet as on 31.03.2019

Liabilities	In lakh	Assets	In Lakh
Equity	8.00	Land & Building	2.85
7@ Preference Share	2.00	Plant & Machinery	5.60
Reserve & Surplus	3.25	Furniture & Fixture	0.68
Term Loans	2.40	Investment at cost	1.00
Sundry Creditors	4.35	Inventory	5.40
Outstanding expenses	0.46	Sundry Debtors	5.14
Provision for taxation	0.80	Bills Receivables	0.60
Proposed Dividend	1.10	Cash in Bank & Hand	1.09
Total Liabilities	**22.36**	**Total Assets**	**22.36**

Profit & Loss Account for the year ended 31.03.2019

Particulars	In lakh	Particulars	In Lakh
To Opening Stock	1.50	By Sales	41.50
To Purchase	12.75	By Closing Stock	1.75
To Direct wages	6.00		
To Factory Expenses	12.95		
To Gross profit	10.05		
	43.25		**43.25**
To Selling & Dist. Expenses	5.20	By Gross Profit	10.05
To Administrative Expenses	2,80	By other income	0.25
To Net Profit	2.30		
	10.30		10.30
To Provision for taxation	0.80	By Net Profit before tax	2.30
To Proposed dividend	1.10		
To General Reserve	0.40		
	2.30		**2.30**

As a Cost Auditor, determine

(i) Capital Employed

(ii) Net Worth

(iii) Profit before Tax

(iv) Calculate the necessary ratios and give your comment on the Performance of the company.

Answer:

(i) Fixed Asset = 2.85 + 5.60 + 0.68 = ₹ 9.13 lakh

(ii) Current Asset = 5.40 + 5.14 + 0.60 + 1.09 = ₹ 12.23 lakh

(iii) Total Asset = Fixed Asset + Current asset = 9.13 + 12.23 = 21.36 lakh

(iv) Current Liabilities = 4.35+ 0.46+ 0.80 + 1.10 = ₹ 6.71 lakh

(v) Capital employed = Total asset – Current liabilities = 21.36 – 6.71 = ₹ 14.65 lakh

(vi) Net worth = 8.00 + 2.00 + 3.25 = ₹ 13.25 lakh

(vii) Profit before Tax = ₹ 2.30 lakh

(viii) Working Capital = 12.23 – 6.71 = 5.52 lakh

Calculation of various Ratios / Turnover ratios:

(i) Profit on Capital employed = (2.30 /14.65) × 100=15.70%

(ii) Profit before tax to Sales = (2.30 /41.50) × 100 = 5.54%

(iii) Current Assets / Current Liabilities = 12.23 / 6.71 = 1.82 times

(iv) Net worth to Long term borrowings = (13.25 /2.40) × 100 = 552.08%

(v) Net Worth to Capital Employed = (13.25 /14.65) × 100 = 90.44%

(vi) Capital Employed to Cost of Production = (14.65/34.25) × 365 days = 156.12 days

(vii) Working Capital to Cost of Production = (5.52/34.25) × 365 days = 58.82 days

Observation:

The company having sound Net worth to capital employed of 90.44% with reasonable Return on Capital employed at 15.70%. Further being low borrowing, company runs very low risk of defaults. Net worth to long term borrowing stands at 552.08%. Working capital position is also good as the working capital to Cost of production stands at 58.82 days. Current asset ratio is also satisfactory which is 1.82 times.

Working:

Calculation of Cost of Production:

Particulars	**Amount (In lakhs)**
Purchase	12.75
Stock Adjustment (1.50-1.75)	- 0.25
Direct Wages	6.00
Factory Cost	12.95
Admin OH	2.80
Cost of Production	**34.25**

***Note**- Investment not considered as part of Capital Employed.

Study Note – 9

BASICS OF MANAGEMENT AUDIT

Learning Objective: *This chapter discusses about Management Audit which involves the review of managerial aspects like organizational objective, policies, procedures, structure, control and system in order to check the efficiency or performance of the management over the activities of the Company.*

It goes beyond the conventional audit which involves a scrutiny of financial transactions and the books of accounts. It is a comprehensive and a critical review of all aspects of management.

1. Choose the correct option among four alternative answer and justify your answer:

(i) Which of the following technique is not followed by management auditor for carrying a management audit?

(a) Accounting technique

(b) Statistical technique

(c) Management technique

(d) Personnel technique

(ii) The main objectives of management audit is to _______ .

(a) Suggest improvement in methods of operations

(b) Framing basic policies for the organisation

(c) Setting up an organizational framework

(d) None of these

(iii) Management audit is the unique process ofthe performance of directors, managers or the performance of Management.

(a) Appraising

(b) Calculating

(c) Auditing

(d) Planning

(iv) Management Audit is requirement of ______ .

(a) Statutory compliance

(b) Statutory/ voluntary compliance

(c) Voluntarily by management

(d) Statutory in some cases

(v) Management audit is normally presumed to be into a performance of ______ manager or group of managers.

(a) Routine investigation

(b) Non-routine investigation

(c) Auditing

(d) None of these

Answer:

(i) (c) Management technique

There are five techniques which are followed by management auditor i.e. accounting technique, scientific technique, statistical technique, personnel technique & general technique.

(ii) (a) Suggest improvement in methods of operations

(iii) (a) Appraising

(iv) (c) Voluntarily by management

Management audit is not a statutory compliance. It is depend up on the management of the company.

(v) (b) Non-routine investigation

2. (a) What is management audit and what is its relevance in today's business scenario?

(b) State the essential qualities required of a Management Auditor.

Answer:

(a) Management Audit is the total examination of transaction of an organisation, or parts of it, and includes checks on the effectiveness of managers, their compliances with company on professional standard, the reliability of management functioning, the quality of performance of duties and recommendations for improvement. Management audit is the systematic and dispassionate examination, analysis and appraisal of management's overall performance.

The relevance of management audit in today's business are as follows -

1. appraise the management performance at all the levels;
2. Spotlight the decision or activities that are not in conformity with organizational objectives.
3. ascertain that objectives are properly understood at all levels;
4. ascertain that controls provided at different levels are adequate and effective in accomplishing management objectives or plans of operations;
5. Evaluate plans which are projected to meet objectives.
6. Review the company's organizational structure, i.e. assignment of duties and responsibilities and delegation of authority.

(b) The essential qualities of a Management Auditor are:

1. Ability to grasp business problems.
2. Ability to determine or assist the progress of the organization.
3. Knowledge of the principles of delegation of authority and control and the preparation of different budgets.
4. Power of grasping and understanding different internal control devices.
5. General understanding of different laws.
6. Sufficient knowledge and experience in preparing various reports for submission to different levels of management including the top management.
7. Tactfulness, perseverance, pleasing and dynamic personality.

3. (a) What are the steps followed in Management audit?

(b) What are the objective of management audit?

Answer:

(a) Steps of management audit :

The following are the steps which needs to be follow during management audit:-

1. Select an area of operation of management
2. Establish what should be the objective, standard or target of the operation.
3. Determine whether the actual results meet the standards, norms or targets. If not, why not?

(i) Is the target too difficult?

(ii) Is failure to achieve the target costing the organisation?

4. Establish what is done to ensure the achievement of the norms, target and standards. What steps are taken for –

   (i) planning

   (ii) Operations, execution and implementation e.g. sue of up-to- date technology.

   (iii) Measurement of performance and controls?

5. Carryout a detailed investigation, collective evidence as well as document for audit findings

6. Report the findings of the audit and make recommendations.

(b) The objectives of management audit can be summarized as follows:-

To ensure optimum utilization of all the resource employed, including money, materials, machines, men and methods;

To highlight inefficiencies in objectives, policies, procedures and planning;

To suggest improvement in methods of operations;

To highlight weak links in organizational structure and in internal control systems, and suggest necessary Improvements;

To help management by providing health indicators and help prevent sickness or help cure in case of Sickness; and

To anticipate problems and suggest remedies to solve them in time.

4. (a) Briefly describe the uses of management audit?

(b) What are the techniques followed by Management auditor for carrying management audit?

Answer:

(a) A management audit is an assessment of how well an organization's management team is applying its strategies and resources. A management audit evaluates whether the management team is working in the interests of shareholders, employees, and the company's reputation. The following are the 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.

(b) 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) Inter firm 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

5. Write Short note:

(a) Management Audit Programme (MAP)

(b) Management audit report

Answer:

(a) Management audit programme (MAP)

Management audit programme is an essential prerequisite to conducting the audit. It is a plan of action drawn in advance of taking up the audit, and to help the auditor to cover the entire area of his function thoroughly.

He should lay down for himself a proper procedure to be followed to complete the work in time, giving thorough coverage to all aspects.

An efficient management audit programme shall comprise the following:

(i) Review of the organisational objectives and plans Study of the policies and practices of the management

(i) A critical review of the organizational structure

(ii) Study of the systems and procedures

(iii) Evaluation of operations

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

(v) Exercise of proper management control

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

(vii) Check on adherence to the statutory obligation and

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

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.

(b) Management Audit Report (MAR)

It is of important to prepare a good MAR. A good MAR can motivate the management and get the required results.

There are the basic characteristics of a good management audit report which can be summarized as follows:

(i) Pertinence

(ii) Comprehensiveness

(iii) Brevity

(iv) Timeliness

(v) Motivating

(vi) Formatting

Contents of the Management audit 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 very 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 from 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.

Study Note – 10

MANAGEMENT AUDIT IN DIFFERENT FUNCTIONS

Learning Objective: ***Management Audit is a systematic examination of decisions and actions of the management to analyse the performance. Management audit involves the review of managerial aspects like organizational objective, policies. Management audit helps the manager of the internal audit function and tries to contribute to the overall continuous improvement of the organization in general.***

1. Choose the correct option among four alternative answer and justify your answer:

(i) The consumer service audit critically examines:

(a) Outstanding payment of consumers.

(b) Price consumers are ready to pay for particular product/service

(c) An appraise management of business enterprise of responsibility towards consumers.

(d) Demand of a product by consumers.

(ii) Important point in Corporate planning is _______

(a) Time and Work Study

(b) Imposing Control System

(c) Forecasting and goal setting.

(d) SWOT analysis.

(iii) Assurance engagements involve _______

(a) Only Individual Parties

(b) Three separate parties.

(c) Contractor and Contractee

(d) None of them

(iv) Management Audit Report Submitted to:

(a) Cost Audit Branch

(b) Audit Committee

(c) Central Government

(d) Management of Concern

(v) Consumer Service Audit is part of ______

(a) Business Activity Audit

(b) Social Audit

(c) Service Audit

(d) None of Above

(vi) There are no fixed items of evidence to be checked by Management Auditor.

A Management Auditor has to rely more on ______

(a) his experience and acumen.

(b) Auditors Working Paper.

(c) Physical Verification Sheet.

(d) Information Provided by Management.

(vii) Zero base budget (ZBB) system was modeled by ______

(a) Peter A. Woodcock.

(b) Peter A. Phyrrh.

(c) P F Ducker

(d) None of them

(viii) Efficiency Audit ensures ______ return on Capital Employed.

(a) optimum

(b) maximum

(c) minimum

(d) average

(ix) Who appoints Management Auditor

- **(a) Departmental Head**
- **(b) Board of Directors**
- **(c) Shareholders**
- **(d) Chairman of the company**

(x) Who is the developer of Management Audit.

- **(a) T. G. Rose**
- **(b) T. G. Tailors**
- **(c) M. C. Sukla**
- **(d) None of them**

Answer:

(i) (c) An appraise management of business enterprise of responsibility towards consumers.

The audit is based on the philosophy that the role of business should be conducive to raising the quality of life through its contribution in terms of better product-quality and services by making available the products and services of the right qualities at the right time, in right quantity, at the right place and right price.

(ii) (d) SWOT analysis

A SWOT- strengths, weaknesses, opportunities and threats analysis canhelpidentify and understand key issues affecting the business.

(iii) (b) Three separate parties.

The parties are a public accountant in practice, a responsible party and intended users.

(iv) (b) Audit Committee.

Management audit is submitted to Audit committee who review the same and advise for any corrective action.

(v) (b) Social Audit.

Consumer Service Audit is an audit of public responsibility of business enterprise in relation to its customers and is a part of social audit. The audit is based on the philosophy that the role of business should be conducive to raising the quality of life through its contribution in terms of better product-quality and services.

(vi) (a) His experience and acumen.

A Management Auditor has to rely more on his experience and acumen to identify areas of review. There are no fixed items of evidence to be checked by Management Auditor.

(vii) (b) Peter A. Phyrrh.

Zero base budget (ZBB) System was modeled by Peter A. Phyrrh.

(viii) (a) Optimum.

The main purpose of Efficiency Audit is to ensure —

That every rupee invested in capital or in other fields give optimum returns, and

The balancing investment between different functions and aspects designed to give optimum results.

(ix) (b) Board Of Directors

Board of Directors appoint the Management auditor

(x) (a) T. G. Rose

T. G. Rose developed the concept of Management Audit as a logical system of evaluating the quality of Management.

2. (a) What do you mean by corporate services? Why it is required? Give some examples.

(b) State the essential qualities required of a Management Auditor.

Answer:

(a) The term "Corporate Services" refers to the activities that combine or consolidate certain enterprise-wide needed support services, provided based on specialized knowledge, best practices, and technology to serve internal (and sometimes external) customers and business partners. This corporate services helps companies to remain competitive in tough battles for achieving greater efficiencies, differential products and services, to improve their corporate services. It enables the companies to developing core competencies to keep its edge over its industry competitors. It sometimes amounts to combining operations with another competitor in the same industry to increase competitive strengths and lower competition among industry rivals. The business world is now becoming increasingly information intensive and complex. Therefore, companies have begun to incorporate web-based services into the work place to reduce cost and improve efficiency.

Corporate services are the support infrastructure of a company. These include

Public relations,

Customer assistance or call centers,

Ttraining,

Engineering,

Human resources and procurement etc.

Corporate services create new business value and help the company function more effectively by improving internal processes and managing customer relationships. The advantages of corporate services are productivity gains, cost savings and service improvement.

(b) The Essential Qualities of a Management Auditor are:

(i) Ability to grasp business problems.

(ii) Ability to determine orassist the progress of the organization.

(iii) Knowledge of the principles of delegation of authority and control and the preparation of different budgets.

(iv) Power of grasping and understanding different internal control devices.

(v) General understanding of different laws.

(vi) Sufficient knowledge and experience in preparing various reports for submission to different levels of management including the top management.

(vii) Tactfulness, perseverance, pleasing and dynamic personality.

3. What is meant by “Corporate Services Audit”?

Describe the areas of the “Corporate Services Audit”, the scrutiny thereof and evaluation criteria used in the Audit.

Answer:

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

The areas of Corporate Service Audits are:

Consumers - Quality goods in right qualities at right price place and time. Employees - Pay, training, safety, welfare, industrial relations, etc.

Shareholders - Safety of investment, satisfactory return, appreciation (in Value & Quantity & marketability)

Community - Social Cost and Social benefit public relations.

Fellow - Business ethics and fair trade dealings.

Businessmen

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

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

4. (a) Evaluation of the personnel function of an organization by management auditor is by no means an easy task. In yourview what areasaretobe covered and pointstobe keptin mind while assessing the personnel function of an organization?

(b) While performing an Information System Audit, the Management Auditor should make sure that various objectives are met. Briefly describe them.

Answer:

(a) The personnel management is concerned with managing people at work for development of efficient and loyal employees for attainment of organization goals. So evaluation personnel function is not an easy task. The important areas to be covered by management auditor while evaluating personnel function are as follows:

(i) Methods followed for manpower planning, recruitment, training, promotion and transfers.

(ii) Action plan for reducing absenteeism.

(iii) Procedure for analysis of labour turnover and steps taken for reduction of the same.

(iv) Method adopted for developing wage and salary structure.

(v) Incentives plan–financial, i.e., bonus, increment etc. and non-financial e.g job enrichment, promotion etc.

(vi) Welfare and safety measures adopted including social security measures and community development programmes.

(vii) Performance appraisal system of the organization.

(viii) Measures undertaken to boost employee morale.

The following points to be kept in mind while assessing the personnel function of an organization:

(i) It is difficult to exactly quantify the influence of human factors and its contribution to success or failure of the organization.

(ii) Development of a uniform yard stick for measurement of performance of a large group of workersis also not easy.

(iii) Workers get influenced by the overall industrial environment.

(iv) Motivating the employees towards achievement of organization goals is a very important as well as difficult task.

(v) The management auditor should assess whether the managers possess necessary leadership qualities and dynamic ideas to motivate their personnel.

(vi) The personnel function is a very important function because in the absence of a well-organized personnel function, the company will not be able to utilize the other resources in optimum manner. Human resource is the most important resource in any organization.

(b) While performing an Information System audit, Management Auditors should ascertain that the following objectives are met:

(i) Security provisions protect computer equipment's, programs, communications and data from unauthorized access, modification, or destructions.

(ii) Program development and acquisition is performed in accordance with management's general and specific authorization.

(iii) Program modifications have the authorization and approval of management.

(iv) Processing of transactions, files, reports and other computer records is accurate and complete.

(v) Source data that is inaccurate or improperly authorized is identified and controlled according to prescribed managerial policies.

(vi) Computer data files are accurate, complete and confidential.

5. (a) XYZ Ltd. engaged in manufacturing of engineering goods is consistently recording higher sales turnover, but declining net profits since the last 5 years. As an management consultant appointed to find out the reasons for the same, what are the points you would verify?

(b) What do you understand by "Energy Audit"? Briefly state the functions of energy auditor.

Answer:

(a) As per the facts that there has been consistently high turnover but declining net profits is an anomalous situation. It may be attributed to one or more following reasons requiring further investigation:

(i) Unfavourable Sales mix: Where the company sells different engineering products with different product margins, the product with the maximum PV ratio/margin should have a higher share in the total sales. If due to revision of sales mix, more quantities of unprofitable products are sold, profits will be reduced inspite of an increase in sales.

(ii) Negative Impact of Financial Leverage: Where the company does not have sufficient own funds (equity) but has a higher debt-equity ratio, the interest commitments will be higher. As the volume of its operation increases, higher debt and interest charges would result in lower profits.

(iii) Other Items Included in Sales: The figure of sales as per Profit and Loss Account may include incidental revenues, e.g., freight, excise duty, sales-tax, etc. where the amount of excise duty goes up considerably the total sales may show an increase which is not represented by a real increase in sales quantity/value.

(iv) High Administrative and Selling Expenses: Administrative and selling costs are generally period costs which are fixed in nature. Their increase is generally not proportional to sale increase. However, a reduction in profit could also be due to increase in administrative overheads and sales overheads at a rate higher than the rate of increase in sales.

(v) Cost-Price Relationship: If the increases in cost of raw materials and labour has not been compensated by a corresponding increase in the sales price this would also result in higher sales and declining profits. Inspite of same sales quantity, for the increasing cost of raw materials and other services, per unit values of the product has been increased which is however unmatched by the increase in cost.

(vi) Competitive Price: Where sales have been made at cut-throat prices in order to eliminate competition from the market, the profits would be in the declined trend in the short-run.

(vii) Additions to Fixed Assets: Where there are heavy additions to fixed assets and consequent depreciation charges in the initial years of additions, there may be reduction in profits in spite of increased sales.

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

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

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

(i) Quantification of energy costs and quantities

(ii) To correlate trends of production or activity to energy cost.

(iii) To devise energy database formats to depict to correct picture – By product, department or consumer.

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

(i) To analyses the historical energy consumption and cost data.

(ii) To conduct preliminary energy audit with the objectives to identify:

(a) Major energy consuming equipment and process;

(b) Obvious inefficiencies and energy wastes; and

(c) Priority areas for further detailed investigation.

(iii) To conduct detailed technical and economic analysis of energy efficiency measures involving large efficiency measures involving large capital investment or long payback periods.

6. (a) What is Pollution of Environment? What are different types, cause and effects of environmental pollution.

(b) State four objectives of operational audit.

Answer:

(a) Environment includes entire biological, physical and social milieu in which man and other organisms are placed. With a view to improving living and nutritional standards, man has interfered with practically every sphere in natural ecosystem. In order to make progress, man has produced destructive, hazardous and often irreversible changes in the environment on which he is totally dependent. The man-made pollutants that greatly influence the quality of environment are – metals, petroleum products, volatile industrial chemicals, heat and exhausts generated due to the burning of fossil fuels, radioactive species from reactors and nuclear reactors, organic and domestic wastes – as most of these are discharged untreated into the environment. Pollution is thus a kind of interference to the environment degradation.

Various types, cause and effects of environmental pollution are :

1. Air pollution
2. Water pollution
3. Noise pollution
4. Smell pollution
5. Thermal pollution

6. Visual pollution
7. Climate pollution
8. Radiation pollution
9. Soil/land pollution *etc.*

(b) Generally, operational audit objectives include:

Appraisal of controls: The most significant gain an organization can derive from operational auditing is probably in the area of appraisal of controls.

a. Evaluation of performance: In performance appraisal, the operational auditor is basically concerned not so much with how well technically the operations are going on, but with accumulating information and evidence to measure the effectiveness, efficiency and economy with which the operations are being carried on.

b. Appraisal of objectives and plans: Operational auditor may look into the aspects like whether objectives are clearly spelt out and properly communicated to the personnel responsible for implementation and whether the personnel have understood the objectives in the sense meant by the management. Also, he can take note of any apparent conflict in the objectives for its effect on operations.

c. Appraisal of organizational structure: Organizational structure provides the line of relationships and delegation of authority and tasks. Therefore, this is also another important area for appraisal by the operational auditor.

d. Program development and acquisition is performed in accordance with management's general and specific authorization.

e. Program modifications have the authorization and approval of management.

f. Processing of transactions, files, reports and other computer records is accurate and complete.

g. Source data that is inaccurate or improperly authorized is identified and controlled according to prescribed managerial policies.

h. Computer data files are accurate, complete and confidential.

7. (a) Write short note on - Probable format of environmental statement.

(b) What points should you consider as an Management Auditor performing CSR Audit?

Answer:

(a) The following are the main aspects which may be covered in the probable format of Environmental Statement:

a. Name and address of the owner/occupier of the industry, operation or process.

b. Date of last environmental audit report submitted.

c. Consumption of water and other raw materials during current and previous year.

d. Pollution generated in air and water along with the output and the types of pollutants and the deviation from standards.

e. Generation of hazardous waste in current year and previous year from processes.

f. Quantity of solid waste generated during current year and previous year and from recycling or reutilization of waste, etc.

g. Disposal practice for different type of waste.

h. Practice in operation for conservation of natural resources.

i. Additional investment proposal for environmental protection including abatement of pollution.

(b) The concept of CSR rests on the ideology of give and take. Companies take resources in the form of raw materials, human resources etc. from the society. By performing the task of CSR activities, the companies are giving something back to the society. India`s new Companies Act 2013 has introduced several new provisions which change the face of Indian corporate business. One of such new provisions is Corporate Social Responsibility (CSR).

A CSR audit program can cover all or any of the following risks: -

- ✓ Effectiveness of the operating framework for CSR implementation
- ✓ Effectiveness of implementation of specific, large CSR projects
- ✓ Adequacy of internal control and review mechanisms
- ✓ Reliability of measures of performance
- ✓ Management of risks associated with external factors like regulatory compliance, management of potential adverse NGO attention, etc.

A CSR Audit should cover the following points:

- ✓ **Human Rights:** Fundamental Human Rights, Freedom of association and Collective bargaining, Non discrimination, Forced labor, Child labor
- ✓ **Business behaviour:** Relations with clients, suppliers and sub-contractors, Prevention of corruption and anticompetitive practices
- ✓ **Human Resources:** Labor relations, Working conditions including steps taken for preventing accidents and health hazards, health and safety measures including compensation in case of any accidents, career development and training, Remuneration system that motivates the employees.
- ✓ **Corporate Governance:** Board of Directors, Audit and internal controls, Treatment of shareholders, Executive remuneration.

- ✓ **Environment:** Incorporation of environmental considerations into the manufacturing and distribution of products, and into their use and disposal, effect on pollution, pollution control measures undertaken,
- ✓ **Community Involvement:** Impacts on local communities, contribution to social and economic development, General interest causes, creation of socials infrastructure like roads, schools, hospitals.

8. Write Short Notes

(a) What do you understand by environment audit and productivity audit?

(b) "Management Audit team should be multidimensional." — Discuss.

(c) What are the Management Audit Questionnaires?

Answer:

(a) Environment Audit is a systematic, documented, periodic and objective review by related entities, of facility operations and practice related to meeting environment requirements.

Whereas 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.

(b) 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 multi dimensional approach to audit function.

(c) A management audit questionnaire is an important tool for conducting the management audit. It is through these questionnaires that the auditors make an inquiry into important facts by measuring current performance. Such questionnaires aim at a comprehensive and constructive examination of an organization's management and its assigned tasks.

Study Note – 11

INTERNAL CONTROL, INTERNAL AUDIT AND OPERATIONAL AUDIT

Learning Objective: ***Internal control, as defined in accounting and auditing, is a process for assuring of an organization's objectives in operational effectiveness and efficiency, reliable financial reporting, and compliance with laws, regulations and policies. Operational audit is a future-oriented, systematic, and independent evaluation of organizational activities. In Operational audit financial data may be used, but the primary sources of evidence are the operational policies and achievements related to organizational objectives. Operational audit is a more comprehensive form of an internal audit. This chapter discusses all those topics mentioned above.***

1. Choose the correct option among four alternative answer and justify your answer:

(i) Company need to file in form ______ with ROC on appointment of Internal auditor.

(a) MGT-14

(b) MGT-9

(c) CRA-3

(d) MGT-15

(ii) NGO(s) are incorporated under

(a) Societies Registration Act, 1860

(b) India Trust Act, 1882

(c) As Section 8 Company

(d) All of the above.

(iii) Who can be appointed as Internal Auditor as per the Companies Act, 2013

(a) A Chartered Accountant

(b) A Cost Accountant

(c) Such other professional

(d) All of the above

(iv) An audit of or for a government agency is composed

(a) Financial compliance

(b) Economy and efficiency

(c) Program results.

(d) All of the above.

(v) Every unlisted public company having turnover _____ during the preceding financial year shall require to appoint Internal Auditor u/s 138 of companies' act 2013.

(a) 50 crore

(b) 200 crore or more

(c) 100 crore or more

(d) None ofabove

(vi) Which section of Companies Act deals with Internal Audit

(a) Section 138

(b) Section 148

(c) Section 139

(d) Section 192

(vii) C&AG has right to direct the manner in which the company's accounts shall be audited by the auditor and to give such auditor instructions in regard to any matter relating to the performance of his functions as per section _____

(a) 44AB of income Tax

(b) 143 of the Companies Act, 2013

(c) 173 of the Companies Act, 2013

(d) 134 of the Companies Act, 2013

(viii) Non-Governmental Organizations can be incorporated as a company

(a) Section 25 of the Companies Act, 1956.

(b) Section 8 of the Companies Act, 2013.

(c) Section 28 of the Companies Act, 2013.

(d) None of the above

(ix) Co-operative Auditor has to conduct an examination of the overdue debts, if any, and a valuation of the assets and liabilities of the society while conducting internal audit as per

(a) Section 17(3) of the Cooperative Societies Act, 1912

(b) Section 17(2) of the Cooperative Societies Act, 1912

(c) Section 17(5) of the Cooperative Societies Act, 1912

(d) Section 37(2) of the Cooperative Societies Act, 1912

(x) Who appoint the auditor for Government Company?

(a) Board of Directors

(b) Audit Committee.

(c) C&AG

(d) CBDT

(xi) Financial Administration of Local Bodies includes

(a) Budgetary Procedure

(b) Expenditure Control

(c) Accounting System

(d) All of the above

Answer:

(i) (a) MGT-14

The company is required to file Form MGT-14 with the Registrar within 30 days from the date of passing of resolution by the Board regarding appointment of Internal Auditor.

(ii) (d) All of the above.

Non-Governmental Organizations (NGO) are generally incorporated as societies under the Societies Registration, Act, 1860 or as a trust under the India Trust Act, 1882, or under any other law corresponding to these Acts enforced in any part of India. NGO's can also be incorporated as a company under section 8 of the Companies Act, 2013.

(iii) (d) All of the above.

AS per Section 138 of the Companies Act, 2013 an internal auditor, 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.

(iv) (d) All of the above.

An audit of or for a government agency is composed of three elements are as under

1. Financial compliance,
2. Economyand efficiency, and
3. Program results.

The typical definition of a financial audit would not include elements 2 and 3. These are operational auditing techniques.

(v) (b) 200 crore or more

Section 138 read with rule 13 of the Companies (Accounts) Rules, 2014 provide that every unlisted public company turnover of `200 or more during the preceding financial year shall require to appointment Internal Auditor.

(vi) (c) Section 138 of the Companies Act 2013

Section 138 of the Companies Act 2013 deals with provisions of Internal Audit.

(vii) (b) Section 143 of the Companies Act, 2013

The C&AG have powers under section 143 of the Companies Act, 2013 as follows:

To direct the manner in which the company's accounts shall be audited by the auditor and to give such auditor instructions in regard to any matter relating to the performance of his functions as such.

(viii) (b) Section 8 of the Companies Act, 2013.

Non-Governmental Organisations are generally incorporated as societies under the Societies Registration, Act, 1860 or as a trust under the India Trust Act, 1882, or under any other law corresponding to these Acts enforced in any part of India. NGO's can also be incorporated as a company under section 8 of the Companies Act, 2013.

(ix) (b) Section 17 (2) of the Co-operative Societies Act, 1912

Section 17 (2) of the Co-operative Societies Act, 1912 specifically requires the auditor to conduct an examination of the overdue debts, if any, and a valuation of the assets and liabilities of the society.

(x) (c) C&AG.

The auditor of a government company is appointed by the C&AG.

(xi) (d) All of the above.

Financial Administration of Local Bodies has three components Budgetary Procedure, Expenditure Control and Accounting System.

2. (a) ITC Ltd. organized a three-day International Conference of Accountants in Mumbai. You are asked to conduct internal audit the accounts of the conference. Draft the internal audit programme for audit of receipt of participation fees from delegates to the conference.

(b) What is the role of auditor in internal control system?

Answer:

(a) Audit of Receipts of Participation Fees The organization of three-day

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

Internal Control System

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

Rate of Participation Fees

- ✓ Verify with reference to resolution passed by the Organizing Committee of ITC LTD.
- ✓ Also verify the rate from the literature/registration form circulated for promotion of conference.

Receipts of Participation Fees

- ✓ Verifycounterfoil of the receipts issued for individual registration.
- ✓ Ensure that receipts are issued for all the registration received in cash.
- ✓ Trace the receipts in Bank Statement or Cash Book – as the case may be.
- ✓ Verify Bank Reconciliation Statement and list out dishonored cheques.
- ✓ Verify subsequent recovery in respect of dishonored cheques.

Overall Checking

Verify the total receipts of participation fees shown in the financial statements with reference to total number of receipts issued to participants. Cross check the total number of delegates with reference to the following:

- ✓ Kits distributed to participants.
- ✓ Bill of caterer for providing meals during conference.

- ✓ Capacity of the Hall.
- ✓ Certificate if any issued.

Foreign Delegates

In case of foreign delegates – if registration fees are higher – ensure

that they are registered at higher fees.

Special Issues:

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

(b) The auditor shall determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control. If the auditor has identified one or more deficiencies in internal control, the auditor shall determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant deficiencies.

The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis. The auditor shall also communicate to management at an appropriate level of responsibility on a timely basis:

In writing, significant deficiencies in internal control that the auditor has communicated or intends to communicate to those charged with governance, unless it would be inappropriate to communicate directly to management in the circumstances; and

Other deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention. The auditor shall include in the written communication of significant deficiencies in internal control:

(a) A description of the deficiencies and an explanation of their potential effects; and Sufficient information to enable those charged with governance and management to understand the context of the communication. In particular, the auditor shall explain that:

(i) The purpose of the audit was for the auditor to express an opinion on the financial statements;

(ii) The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control; and

(iii) The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to those charged with governance.

3. (a) What is Audit programme? What are the advantages of Audit Programme?

(b) What are the limitations of internal control system?

Answer:

(a) An audit programme is a detailed plan of the auditing work to be performed, specifying the procedures to be followed in verification of each item and the financial statements and the estimated time required. To be more comprehensive, an audit programme is written plan containing exact details with regard to the conduct of a particular audit. It is a description or memorandum of the work to be done during an audit. Audit programme serves as a guide in arranging and distributing the audit work as well as checking against the possibility of the omissions.

Advantages:

The main advantages of an audit programme are as follows:

- ✓ It serves as a ready check list of audit procedures to be performed.
- ✓ The audit work can be properly allocated to the audit assistants or the article clerks.
- ✓ The auditor may easily know the extent of work done at any point of time. Thus, the progress of work done can be under the supervision and control of the auditor.
- ✓ Audit programme would not only be useful for the audit assistants in carrying the audit work but for the principal too as he would be in a position to account for the individual responsibilities.
- ✓ A uniformity of the work can be attained as the same programme would be followed from time to time. It is a useful basis for planning the programme for the following year.
- ✓ It may be used as evidence by the auditor in the event when any charge is brought against him. He can prove that there has no negligence on his part and he exercised reasonable care and skill while performing the task.

(b) Internal control can provide only reasonable, but not absolute, assurance that the objectives" stated above are achieved. This is because there are some inherent limitations of internal control, such as:

1. **Cost:** management's consideration that a control be cost- effective;
2. **No control for unusual transaction:** the fact that most controls do not tend to be directed at transactions of Unusual nature;
3. **Human Error:** the potential for human error; These include the realities that human judgement in decision- making can be faulty and that breakdowns in internal control can occur because of human error. For example, there may be an error in the design of, or in the change to, a control.
4. **Collusion among employees:** the possibility of circumvention of controls through collusion with parties outside the entity or with employees of entity; For example, management may enter into side agreements with customers that alter the terms and conditions of the entity's standard sales contracts, which may result in improper revenue recognition.

5. **Abuse of authority:** the possibility that a person responsible for exercising control could abuse that authority, for example, a member of management overriding a control;
6. **Inadequate procedure:** The possibility that procedures may become inadequate due to changes in Conditions and compliance with procedures may deteriorate;
7. **Manipulations by management:** with respect to transactions or estimates and judgments required in the preparation of financial statements.

4. Write short notes on:

(a) Propriety Audit in the Context of Government Audit?

(b) Audit Committee under The Companies Act 2013?

(c) Operational Audit

Answer:

(a) Under propriety audit‘, the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations.

(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:

- ✓ all public companies with a paid up capital of ₹10 Crores or more;
- ✓ all public companies having turnover of ₹100 Crores or more;
- ✓ 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.

(c) An operational audit has been defined as an organized search for ways of improving efficiency and effectiveness. The objective is to assist the organization in performing functions more effectively and economically with focus on the efficiency and effectiveness of operations, it is also stated to be an early warning system for the detection of potentially destructive problems.

5. Factors to be considered by Cost Auditor while evaluating MIS?

Answer:

The need for determining ―production capacity in respect of industrial organisation in India arises from the following reasons:-

- ✓ To meet the requirement under Section 129 of the Companies Act, 2016, that prescribes the form and contents of the balance sheet as well as profit and loss account (Schedule III of the Companies Act).
- ✓ For purpose of Cost Audit Report under section 148 of the Companies Act, 2013 where a cost audit has been ordered by Government.
- ✓ For internal management purpose, to be used:
- ✓ In planning, scheduling and controlling production, and
- ✓ In planning expansion of capacity and correction of imbalances.
- ✓ For assessment of capacities for national level planning.
- ✓ For fixing the price of product(s) after ascertaining the capacity costs and per unit incidence thereof etc.

6. (a) As per Companies Act 2013 which companies are required to conduct Internal Audit?

(b) Who can be appointed as internal auditor as per The Companies' Act 2013?

Answer:

(a) Section 138 of the Companies Act 2013 read with rule 13 - companies(accounts)

Rules , 2014 states that the following class of companies shall be required to appoint an Internalauditorora firmof internal auditors,namely:-

- ✓ Every listed company;
- ✓ Every unlisted public company having-
  - a. Paid up share wealth of fifty crore rupees or more during the preceding financial year; or
  - b. Turnover of two hundred crore rupees or more during the preceding financial year; or
  - c. Outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
  - d. Outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and
- ✓ Every private company having-
  - a. Turnover of two hundred crore rupees or more during the preceding financial year; or

b. Outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year:

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

(b) 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.

So, a chartered accountant or a cost accountant or a such other professional can be appointed as internal auditor of a company as decided by Board to conduct internal audit.

7. (a) Management Audit and Operational Audit are complementary and supplementary to one another". Discuss in brief.

(b) What is the Role of Management with regard to Internal Control

Answer:

(a) Management Audit is wider in scope compared to Operational Audit.

Management Audit is concerned with quality of managing whereas Operational Audit centres on the quality of operation. Operational Audit is an audit for the management and Management Audit is an audit of the management also.

The basic difference between the two audits is not in method, but in the level of appraisal. In management audit, the auditor is to make his tests to the level of top management, its formulation of objectives, plans and policies and its decision making. It is not that he just verifies the operations of control and procedures and fulfilment of plans in conformity with the prescribed policies.

The auditor is to reach the root i.e., the functions of top management which lay down objectives and policies, provide means and procedures of implementation and control and which actually engage in direction and control on a continuous basis. In addition to what would normally be covered in an operational audit, management audit would also encompass the relevance and effectiveness of the aims, duties and decisions of management at various levels, plans, policies and decisions of the top management. Every aspect of the functions of Board of Directors should be in conformity with the objects set out in the constituting document. Similarly, the managing director, if any, should act not only in accordance with the mandate he has received but he should ensure that the decisions he takes are in conformity with the objects of the company and the policies formulated by the Board. The effectiveness of management under the control of managing director and the various members of the Board including those in charge of finance, production, sales etc., should be subject to review of the management auditor.

Therefore, it can be said that the two audits are complementary and supplementary to one another.

(b) The responsibility of Management with regard to internal Control can be summarized as under-

- ❖ Creation of system: Management is responsible for maintaining an adequate accounting system incorporating various internal Controls to the extent appropriate to the size and nature of the Business. The Management is vested with the responsibility of carrying on the business, safeguarding its assets and recording the transactions in the books of account and other records.
- ❖ Review of system: The system installed, should be reviewed by the Management to ascertain, whether-
  - ✓ The prescribed Management policies are being properly interpreted by the employees and are faithfully implemented,
  - ✓ The prescribed procedures need a revision due to changed circumstances or whether they have become obsolete or cumbersome, and
  - ✓ Effective corrective measures are taken promptly when the system appears to breakdown
- ❖ Internal Audit: it is desirable that the Management also installs an internal audit System as an independent function to check, amongst other things, the actual operation of the Internal Control System and report any deviations or non- compliances.

Study Note – 12

CASE STUDY ON PERFORMANCE ANALYSIS

Learning Objective: *Performance Analysis is a task that's done repeatedly. Performance Analysis Reports are referenced at all critical decision-making junctures. These reports are used for external dealings. This chapter deals with performance analysis and its applications.*

1. Choose the right answer:

(i) Gross Sales ₹6500 lacs, GST ₹240 lacs, Increase in stock ₹82 lacs, Cost of raw materials ₹2250 lacs, Power ₹1220 lacs, other overheads ₹ 215 lacs, Depreciation 250 lacs. Value Addition is :

(a) ₹2897 l ac.

(b) ₹2657 Lac.

(c) ₹2407 Lac.

(d) ₹2575 lac.

(ii) A cotton textile mill had cumulative waste percentage of 5% in Blow Room, 6% in Carding, 4% in Drawing, 7% in Simplex and 8% in Ring Frame. For an input of 1000 kg. of cotton in Blow Room, the output at Ring Frame is___________.

(a) 735.27 Kg.

(b) 725.27 Kg.

(c) 745.27 Kg.

(d) 733.49 Kg.

(iii) Financial Position and Ratio Analysis forms part of ________of the Annexure to Cost Audit Report.

(a) Para 4, Part-D

(b) Para 2, Part- C

(c) Para 4, Part-B

(d) Para 3, Part-D

(iv) Royalty paid on units produced ₹22,000, Hire Charges of equipment used for production ₹2,000, Design charges ₹ 15,000, Software development charges related to production ₹22,000. Depreciation ₹1000. The Direct Expenses is:

(a) ₹39000

(b) ₹59000

(c) ₹62000

(d) ₹61000

(v) Which one of the following costs appeared only in Cost Accounts?

(a) Interest on mortgage and loans

(b) Notional Interest on Capital

(c) Dividend equalization fund, sinking, fund etc.

(d) Loss due to scrapping of plan and machinery

(vi) Which one of the followings in an example of ―Solvency Ratio?

(a) Capital turnover Ratio

(b) Debt Equity ratio

(c) Debtors Turnover Ratio

(d) None of above

(vii) Cost of Inventory does not include

(a) Costs of Purchase

(b) Costs of Conversion

(c) Other Direct Cost

(d) Administrative overheads that do not contribute to bringing inventories to their present location and condition

(viii) Which one of the followings in an example of ―Profitability Ratio

(a) Inventory Turnover Ratio

(b) Proprietary Ratio

(c) Expenses Ratio

(d) Capital Gearing Ratio

(ix) The Balance Sheet of A B C Ltd. As on 31st March 2019 showed the following information: Capital - ₹2500 lacs, Reserves - ₹800 lacs, Loans - ₹900 lacs, Sundry Creditors 870 lacs, Total assets - ₹ 5070 lacs. For the year 18-19, PBT - ₹1400 lacs, provision for tax is ₹550 lacs and Proposed dividend is ₹ 620 lacs & Deferred expenditure- ' 480. Return on Net worth is:

(a) 42.42 %

(b) 30.14 %

(c) 28.41 %

(d)25.75%

(x) A factory operates a standard cost system, where 2,000 kgs of raw materials @ ₹12 per kg were used for a product, resulting in price variance of ₹6,000(F) and usage variance of ₹3,000(A). Then what will be the standard material cost of actual production?

(a) 30,000

(b) 24,000

(c) 27,000

(d) 21,000

Answer:

(i) (b) ₹2657 lac.

Value Addition = Gross sales less GST Add Increase in stock less Cost of Raw materials less Power less Other Overheads

=₹6500 – ₹240 + ₹82 – ₹2250 - ₹1220 – ₹215 lac = ₹2657 lac.

(ii) (d) 733.49 kg.

Output at Ring Frame = 1000 × (100-5)% × (100-6)% × (100-4)% × (100-7)% ×(100- 8)%

= 1000 × 95% × 94% × 96% × 93% × 92%

= 733.49 Kg

(iii) (a) Para 4, Part D

As per Companies (Costs Records & Audit) Rules, 2014.

(iv) (d) ₹61000/-

Direct expenses = Royalty paid on units produced+ Hire Charges of equipment used for production+ Design charges + Software development charges related to production =

₹22000 + ₹2000 + ₹15000 + ₹22000 = ₹61000/-

(v) (b) Notional Interest on Capital.

Any Notional Costs are appeared only in cost accounts but not entered in financial accounts as actual outlay has not occurred.

(vi) (b) Debt Equity ratio

Debt Equity ratio represent the long term solvency position of an entity. It is a ratio of debt to equity representing ratio of debt in capital structure.

(vii) (d) Administrative overheads that do not contribute to bringing inventories to their present location and condition.

(viii) (c) Expenses ratio

Expenses Ratio is a profitability ratio with respect to sales. It is a ratio of a particular expense to sales.

(ix) (b) 30.14%

Networth = Capital + Reserves-Revaluation reserve (if any)-accumulated losses (if any)- deferred expenditure (if any)-misc. expenditure not written off (if any)

Networth = ₹2500 + ₹800 – ₹480 = ₹2820,

Total Earning = ₹1400 – ₹550 = ₹850

Return on Networth = ₹850 / ₹2820 = 30.14%

(x) (c) 27,000

Total material cost variance = Material price variance +Material usage variance

= 6,000(F) + 3,000(A)

= 3,000(F)

Actual material cost= 2,000 x 12 = 24,000

Hence, the standard material cost of actual production = 24,000 + 3,000(F) = ₹ 27,000

2. (a) ABC STEEL LTD. has the following Balance Sheet as on March 31, 2019 and March 31,2018.

(Amount in ₹ Lakh)

Year ended March 31	2019	2018
SOURCES OF FUNDS:		
Shareholders' Fund	3,500	3,200
Loan Funds	4,000	3,900
Total Sources of Funds	7,500	7,100
APPLICATIONS OF FUNDS:		
Fixed Assets	3,800	3,600
Cash and Bank	700	650
Debtors	1,500	1,200
Stock	3,500	4,200
Other Current Assets	1,050	1,250
Total Assets	10,550	10,900
Less: Current Liabilities	(3,050)	(3,800)
Net Assets	7,500	7,100

The Income statement of ABC STEEL LTD. for the year that ended is as follows:

(Amount in ₹ Lakh)

Year ended March 31	2019	2018
Sales	30,000	28,000
Cost of Goods Sold	25,500	24,000
Selling, General & Administrative expenses	2,600	2,350
Interest Expenses	1,000	1,100
Tax	300	250

Required:

(I) Calculate for the year 2018-19:

(a) Return on Net Worth

(b) ROI

(c) ROE

(d) Operating Profit Ratios

(e) Give brief comments on the financial position of company.

(b) The following figures are extracted from the statement prepared by the Cost Accountant and the Trial Balance of ABC Ltd., which is a single product company calculate Value Added and its application:

Particulars	**₹ in lacs 31.03.2019**
Net Sales	1,740.00
Raw Materials consumed	1,140.00
Direct Wages	35.00
Power and Fuel	30.00
Stores and Spares	6.00
Depreciation Charged to production cost centres	16.00
Factory Overheads:	
Salaries and wages	45.00
Depreciation	21.00
Rates and Taxes	19.00
Other Overheads	51.00
Administrative Overheads:	
Salaries and Wages	10.00
Rates and Taxes	12.00
Other Overheads	62.00
Selling and Distribution overheads:	
Salaries and Wages	16.00
Packing and Forwarding	18.00
Depreciation	14.00
Other overheads	85.00
Net Profit	**160.00**

Answer:

(a)

(i) Various Ratios for the year 2018 – 2019

(a) Return on Net Worth=Profit after Tax/Net Worth

= 600/3500 * 100 = 17.14%

(b) ROI=Net profit before interest but after tax/ Average Capital employed

= 1600/7300 * 100 = 21.92%

Net profit before interest but after tax=1900-300=1600

Average capital employed=(7500+7100)/2=7300

(c) ROE = PAT available to Equity Share holders/Average shareholders Funds

= 600/3350 =17.91%

Average shareholders' Funds = (3500 + 3200)/2 = 3,350

(d) Operating Profit Ratio = EBIT/ Sales = (1900/30000) × 100 = 6.33%

Working:

(i) Calculation of PAT-

Year ended March 31	2019 (in Lakhs)	2018 (in Lakhs)
Sales	30,000	28,000
Less: Cost of Goods Sold	25,500	24,000
Gross Profit	4,500	4,000
Less: Selling, General & Administrative expenses	2,600	2,350
Earnings before Interest & Tax (EBIT)	1,900	1,650
Less: Interest Expenses	1,000	1,100
Profit before Tax (PBT)	900	550
Less: Tax	300	250
Profit After Tax	600	300

(ii) Comment:

There has been improvement in the PAT of the company which has increased from Rs. 300.00 lakhs to Rs. 600.00 lakhs during the FY 2019. Further all the earnings ratio are quite satisfactory and there is improvement in performance during the year compared to last year. The trend shows sound financial position and better future of the company.

(b)

Value Addition statement of ABC Ltd.

Particulars	₹ In Lakhs
Net Sales **(X)**	**1,740.00**
Less: (i) Cost of Bought out Materials & Services (Raw Materials, Direct wages and Stores & Spares = 1140+35+6)	1,181.00
(ii) Power & Fuel	30.00
(iii) Packing & Forwarding	18.00
(iv) Overheads (excluding Salaries & Wages, Rates & Taxes and depreciation= 51+62+85)	198.00
(Y) = (i) + (ii) +(iii)+(iv)	**1,427.00**
Value Addition : (X) –(Y) =	**313.00**

Application of Value Addition

Particulars	₹ In Lakhs
Value Addition	**313.00**
Application of Value Addition	
Salary Wages (45+10+16)	71.00
Rates & Taxes (19+12)	31.00
Depreciation (16+21+14)	51.00
Profit for the Company	160.00
Total Application	**313.00**

3. PQR LTD. has the following Balance Sheet as on March 31, 2019 and March 31, 2018

(Amount in ₹ Lakh)

Year ended March 31	2019	2018
SOURCES OF FUNDS:		
Shareholders' Fund	3,700	3,000
Loan Funds	3,800	3,500
	7,500	6,500
APPLICATIONS OF FUNDS:		
Fixed Assets	3,100	3,600
Cash and Bank	700	600
Debtors	1,250	1,200
Stock	2,500	2,200
Other Current Assets	950	1,250
Less: Current Liabilities (Includes 20% Trade payable)	(1,000)	(1,750)
	7,500	7,100

The Income statement of PQR LTD. for the year that ended is as follows:

(Amount in ₹ Lakh)

Year ended March 31	2019	2018
Sales (Includes 30% credit sales)	28,000	25,000
Purchase of Goods (Includes 40% credit purchase)	16,500	14,800
Employee Cost	4,950	4,650
Other Production expenses	2,550	2,050

Calculate for the year 2018-19:

(a) Inventory Turnover Ratio

(b) Debtors Turnover Ratio & Average collection period

(c) Creditors Turnover Ratio & Average payment period

Answer:

Various Ratios for the year 2018 – 2019

(a) Inventory Turnover Ratio = Cost of goods sold/Average Inventory

= 24000/2350 = 10.21

Average Inventory = (2500 + 2200)/2 = 2350

(b) Debtors Turnover Ratio = Total credit sales/ Average debtor

Credit sales = 30% * Total sales = 28000 * 30% = 8400

Average debtor = (1250 + 1200)/2 = 1225

Therefore, Debtors Turnover Ratio = 8400/1225 = 6.86

Average Collection period = 365/6.86 = 53 days

(c) Creditors Turnover Ratio = Total credit purchase/ Average Creditor

Credit purchase = 40% * 16500* = 6600

Average Creditor = 20% of Current liabilities

2019 = 20% * 1000 = 200

2018 = 20% * 1750 = 350

Average Creditor = (200 + 350)/2 = 275

Therefore, Creditors Turnover Ratio = 6600/275 = 24

Average payment period = 365/24 = 15 days

Workings:

Cost of goods sold:

Particulars	**₹ In Lakhs**
Purchase of Goods (Includes 40% credit purchase)	16,500
Employee Cost	4,950
Other Production expenses	2,550
Cost of Goods Sold	24,000

4. (a) The following information pertains to NUPUR LTD., a manufacturing cement company for the year that ended as follows:

The year ended March 31.	2018-19	2017-2018
Rated Capacity per Hr (in MT)	80	80
Break down (Hrs)	2,177	1,015
Planned Maintenance (Hrs)	247	422
Power restrictions (Hrs)	1,237	1,481
Shortfall (there are no orders) (Hrs)	792	677
Want of wagons (Hrs)	495	635
Total stoppage (Hrs)	4,948	4,230
Total running (Hrs)	3,888	4,582
Total available Hours	8,836	8,812
Production during the year (in MT)	2,48,844	3,29,928
Hourly Rate of Production (in MT)	64	72
Capacity Utilization (%)	62.21	82.48
Annual Installed Capacity (in MT)	4,00,000	4,00,000

Based on information stated above, you as a Cost Auditor are required to offer your comments on

(i) The performance of the company

(ii) Your suggestion for improvement.

(b) ULTRA CEMENT LTD. has a captive power generation plant for its cement factory. The following information is available with regard to the power generation for the year ended March 31, 2019:

Coal consumption	3600 tonne @ ₹ 900 per tonne
Oil	4000 liters @ ₹ 60 per litre
Water	30000 gallons at ₹ 65 per gallon
Stores and Other Consumables	₹ 55,000

Salaries of power generating plant:

2 supervisors each at '₹10,600 p.m., 5 skilled workers each at ₹6,100 p.m., 3 helpers each at ₹ 4,200 p.m. Salaries to boiler house attendant, 8 workers, each at ₹4,200 p.m. Cost of power generating plant—

₹15,00,000 having life of plant 15 years with ₹ 60,000 residual value. Cost of Boiler plant— ₹6,00,000 having life of plant 10 years with no residual value.

Miscellaneous income received by sale of ash — ₹ 70,000.

Repair and maintenance — Power generating plant ₹ 1,60,000,

Boiler house ₹ 1,42,000.

Share of Administrative Overhead — ₹ 1,65,000.

Power generated during the year: 3125400 KWH.

Note: No power generated is used by the power generated plant itself.

You are required to prepare the Cost Sheet to calculate cost per kWh of electricity generated as per the Companies (Cost Records and Audit) Rules 2014.

Answer:

(a)

(i) Performance of the Company:

(a) Rated capacity in 2017-18= 80 MT/Hr

Hourly rate of production 2017-18= 72MT/Hr

Rated capacity achieved in 2017-18=(72/80)x100 =90%

Rated capacity achieved in 2018-19= (64 /80)x100 = 80%

The capacity achievement as % of rated capacity has declined from 90% to 80% in 2018-19.

Further the Capacity Utilization has gone down to 62.21% in 2017-18 from 82.48% of Previous year; a reduction of 20.27%

1. From the data available the following observations are noted:-Breakdown hours have gone up from 1,015 hours to 2,177 hours, an increase by 114.48%
2. Planned Maintenance hours has reduced from 422 hours to 247 hours i.e. by 41.47%.
3. Shortfall hours due to lack of orders has increased from 677 hours to 792 hours i.e. by 16.99%
4. The total stoppage hours has increased from 4,230 hours to 4,948 hours i.e. by 16.97%.
5. The total running hours has come down from 4,582 hours to 3,888 hours i.e. by 15.15%.
6. The production has come down from 3,29,928 Mt to 2,48,844 Mt i.e. by 24.58%.

From the above findings, it can be pointed out that the underutilization of capacity to the extent of little over 20% can be attributed mainly to:-

- Increased total stoppage hours of 4,948 of 2018-19 as against that of 4,230 hrs in 2017-18 and
- The net increase of 718 hrs (4,948-4,230) is again due to increase of break down by 1,162 hrs (2,177-1,015) in the year 2018-19.

(ii) Suggestion:

Therefore, the Company should look into the aspect of proper maintenance, securing sufficient orders to avoid lost time. Better utilization of capacity can also be achieved by improving availability of wagons. The company may also carry out a cost-benefit analysis to have captive source of power.

(b)

ULTRA CEMENT LTD

STATEMENT SHOWING COST OF POWER GENERATED BY POWER GENERATED PLANT
FOR YEAR ENDED 31 March 2019

Power generated			**3125400 kwh**
Particulars		Total Amount (₹)	Cost Per Kwh (₹)
Coal consumption (3600 × 900)	3240000	3170000	1.01
Less: Sale of Ash	70000		
Oil 4000 litres at ₹ 60 per ltr.		240000	0.08
Water 30000 gallons at ₹ 65/- per gallon		1950000	0.62
Stores and other consumables		55000	0.02
Salaries of generating plant			
Supervisor (2 ×10600×12)	254400		
Skilled Worker (5 × 6100 ×12)	366000	771600	0.25
Helpers (3 x 4200×12)	151200		
Salaries To Boiler House Attendant (8× 4200 ×12)		403200	0.13
Repairs and maintenance Generating plant Boiler house	160000 142000	302000	0.10
Depreciation Generating Plant (1500000-60000)/15Yrs. Boiler House (600000/10Yrs.)	96000 60000	156000	0.05
Share of administrative overhead		165000	0.05
Total cost of power generated		7212800	2.31

So, Cost per KWH of Electricity generated = ₹ 2.31

5. (a) **Purchase of Materials ₹ 4,50,000 (inclusive of Trade Discount ₹ 5,000); Fee on Board ₹ 12,000; Import Duty paid ₹ 18,000; Freight inward ₹ 20,000; Insurance paid for import by sea ₹ 10,000; Rebates allowed ₹ 6,000; Cash discount ₹ 3,000; GST refundable₹ 10,000; Subsidy received from the Government for importation of these materials ₹25,000. Compute the landed cost of material (i.e. value of receipt of material).**

(b) **The Cost Accountant of BASANTI DEVI RICE MILLS LTD. has arrived at a Profit of ₹ 20,10,500 based on Cost Accounting Records for the year ended March 31, 2019. Profit as per Financial Accounts is ₹ 22,14,100.**

As a Cost Auditor, you find the following differences between the Financial Accounts and Cost Accounts:

	Particulars'	Amount (₹)
(1)	Profit on Sale of Fixed Assets	2,05,000
(2)	Loss on Sale of Investments	33,600
(3)	Voluntary Retirement Compensation included in Salary & Wages in F/A	50,25,000
(4)	Donation Paid	75,000
(5)	Insurance Claim relating to previous year received during the year	5,08,700
(6)	Profit from Retail trading activity	32,02,430
(7)	Interest Income from Inter-Corporate Deposits	6,15,000
(8)	Decrease in value of Closing WIP and Finished goods inventory	
	as per Financial Accounts	3,82,06,430
	as per Cost Accounts	3,90,12,500

You are required to prepare a Reconciliation Statement between the two Accounts for the year ended March 31, 2019.

Answer:

(a)

Computation of Material Cost Sheet

	Particulars	Amount (₹)
	Purchase price of Material	4,50,000
Add:	Fee on Board	12,000
Add:	Import Duties of purchasing the material	18,000
Add:	Freight Inward during the procurement of material	20,000

Add:	Insurance paid	10,000
	Total	**5,10,000**
Less:	Trade Discount	5,000
Less:	Rebates	6,000
Less:	GST refundable	10,000
Less:	Subsidy received from the Government for importation of materials	25,000
	Value of Receipt of Material	**4,64,000**

Note:

- ✓ Cash discount is not allowed, as it is a financial item.
- ✓ Subsidy received, rebates and GST refundable are to be deducted for the purpose of computing the material cost.

(b)

RECONCILIATION OF PROFIT BETRWEEN COST AND FINANCIAL ACOUNTS
FOR THE YEAR ENDED ON 31ST MARCH, 2019

Particulars'	Amount (₹)	Amount (₹)
Profit as per Financial Accounts:		22,14,100
Add: Loss on sale of investments	33,600	
Add: Voluntary Retirement compensation included in salary	50,25,000	
Add: Donation paid	75,000	51,33,600
		73,47,700
Less: Profit on Sale of Fixed Assets-Not considered in cost A/c	2,05,000	
Less: Receipts of insurance claim related to previous year	5,08,700	
Less: Profit from Retail trading activity	32,02,430	
Less: Interest income from inter-corporate deposit-not considered in cost accounts	6,15,000	
Less: Difference in valuation of stock:		
Decrease in inventories as per cost accounts : 3,90,12,500		
Decrease in inventories as per financial accounts :3,82,06,430	8,06,070	53,37,200
Profit as per Cost Accounts		**20,10,500**

6. (a) (i) Purchase of material \$ 60,000 [Forward contract rate \$ = 69.40 but \$ = 71.20 on the date of importation]; Import Duty paid ₹ 6,55,000; Freight inward ₹ 1,62,000; Insurance paid for import by road ₹ 55,000; Cash discount ₹ 33,000; GST Credit refundable ₹ 42,000; Payment made to the foreign vendor after a month, on that date the rate of exchange was \$ = 71.80. Compute the landed cost of material.

(b) ANAND (P) LTD. a single product manufacturing company, has following four operations undergone by a product under Cost Audit.

The Process wise Input, Output, Direct Employee Costs and Direct Material Costs for the year ended March 31, 2019 are given below:

Process	Input Unit	Output Unit	Direct employee Cost of the process (₹)	Direct Material Cost of the process (₹)
MP-1	522000	490800	22,08,600	28,46,640
MP-2	565000	486500	34,05,500	20,91,950
MP-3	625000	598000	37,67,400	44,85,000
MP-4	670000	615300	34,45,680	31,99,560

You are required to calculate:

(i) Direct Employee Cost per unit of the product,

(ii) Direct Material Cost per unit of the product,

— Under reference as required in (PART-B, PARA-2) of the Annexure to Cost Audit Report under the Companies (Cost Records and Audit) Rules, 2014.

Answer:

(a)

(i) Computation of Landed Cost of Material

Particulars	Amount in ₹
Purchase price of material [60,000 × 71.20]	42,72,000
Add: Import Duties of purchasing the material	6,55,000
Add: Freight Inward during the procurement of material	1,62,000
Add: Insurance of the material (In case of import of material by road/ Sea)	55,000
Total	**51,44,000**
Less: GST Credit refundable	42,000
Value of Receipt of Material	**51,02,000**

(b) Total employee cost per unit and total material cost per unit of the product under Audit must be an aggregation of process wise employee cost and material costs after taking into account the good units occurring in each process.

Process	Input (unit)	Output (unit)	Factor
Mp-1	522000	490800	522000 ÷ 490800 = 1.0636
MP-2	565000	486500	565000 ÷ 486500 = 1.1614
MP-3	625000	598000	625000 ÷ 598000 = 1.0452
MP-4	670000	615300	670000 ÷ 615300 = 1.0889

A) Process wise Employee costs per unit of output (Product) are:	B) Process wise material cost per unit of output (product) are:
MP-1 = 22,08,600 ÷ 490800 = 4.5	2846640 ÷ 490800 = 5.8
MP-2 = 34,05,500 ÷ 486500 = 7.0	2091950 ÷ 486500 = 4.3
MP-3 = 37,67,400 ÷ 598000 = 6.3	4485000 ÷ 598000 = 7.5
MP-4 = 34,45,680 ÷ 615300 = 5.6	3199560 ÷ 615300 = 5.2

(I) Aggregating all above (A) employee cost to the finished product form process MP-4 will be:

Process MP-1	= ₹4.50	
Process MP-2	= 4.5×1.1614+7	= 12.23
Process MP-3	= 12.23×1.0452+6.3	= 19.08
Process MP-4	=19.08×1.0889+5.6	= 26.38

Direct employees cost per unit of finished product (output) in ₹ 26.38

(II) Aggregating all above (B), material costs to the finished product from process MP-4 will be:

Process MP-1	= 5.80	
Process MP-2	= 5.8×1.1614+4.3	= 11.04
Process MP-3	= 11.04×1.0452+7.5	=19.04
Process MP-4	=19.04×1.0889+5.2	=25.93

Hence, direct material cost per unit of finished product (output) is ₹ 25.93

7. (a) The following are the process-wise input and output in a Spinning Mill –

Blow room :	Cotton processed Laps produced	4672563 kgs 4258274 kgs.
Carding :	Laps processed Silvers produced	4274362 kgs. 3976420 kgs.
Draw frames :	Silvers processed Silvers drawn	3948241 kgs. 3901810 kgs.
Roving (Simplex) :	Drawn silvers processed Transferred to Ring frame	3874125 kgs. 3831510 kgs.
Ring frame :	Silvers used Finished Yarn produced	3911645 kgs. 3641741 kgs.
Reeling and Winding :	Yarn wound Saleable Yarn produced	3635420 kgs. 3580889 kgs.

Calculate the process wise Waste Multiplier factors.

(b) Trial Balance of M/s United Service Ltd. as on 31.3.2019 (relevant extracts only)

Particulars	₹	Particulars	₹
Materials consumed	40,00,000	Special Subsidy received from Government towards Employee salary	3,15,000
Salaries	25,00,000	Recoverable amount from Employee out of perquisites extended	55,000
Employee training cost	2,00,000		
Perquisites to Employees	5,20,000		
Leave Travel concession	65,000		
Contribution to Gratuity Fund	4,00,000		
Lease rent for accommodation provided to employees	3,70,000		
Festival bonus	80,000		
Cost of Employee's stock option	20,000		
Unamortised amount of Employee cost related to a discontinued operation	90,000		

Compute Employee Cost as per CAS 7

Answer:

(a)

Process	Input (kgs)	Output (kgs)	Loss (%)	Output (%)	Waste Multiplier
Total Consumption				100.00	1.316
Blowroom :	4672563 kgs	4258274 kgs.	8.87	= 100-(100*8.87%) = 91.13	1.199
Carding :	4274362 kgs.	3976420 kgs.	6.97	= 91.13-(91.13*6.97%) = 84.78	1.116
Draw frames :	3948241 kgs.	3901810 kgs.	1.18	= 84.78-(84.78*1.18%) = 83.78	1.103
Roving (Simplex) :	3874125 kgs.	3831510 kgs.	1.10	= 83.78-(83.78*1.10%) = 82.86	1.090
Ring frame :	3911645 kgs.	3641741 kgs.	6.90	= 82.86-(82.86*6.90%) = 77.14	1.015
Reeling and Winding :	3635420 kgs.	3580889 kgs.	1.50	= 77.14- (77.14*1.50%) =75.98	1.000

Loss Percentage = (Input-output)/input × 100

Waste Multiplier at each process= Output percentage at each process/ Output percentage at end

i.e. Overall = 100/75.98 =1.316

Blow room waste multiplier = 91.13/75.98 = 1.199 etc. and so on

(b)

Computation of Employee Cost

	Particulars	Amount in ₹
	Salaries	25,00,000
Add	Net Cost of Perquisites to Employees = Cost of Perquisites (-) amount recover able from employee = 5,20,000 (-) 55,000	4,65,000
Add	Lease rent paid for accommodation provided to employee	3,70,000
Add	Festival Bonus	80,000
Add	Leave Travel Concession	65,000
Add	Contribution to Gratuity Fund	4,00,000
Add	Cost of Employee’s Stock Option	20,000
Less	Special subsidy received from Government towards employee salary	(3,15,000)
	Employee Cost	**35,85,000**

Note: 1. Training cost to be treated as overhead and assigned to cost object on appropriation basis, as such number of employee got training department wise.

8. 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.

Answer:

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.

Total (4000 Hrs. + 6000 Hrs.) = 10,000 Hrs.

Capacity ratio Standard capacity usage ratio

= 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%

Activity Ratio

= Actual production in terms of Standards Hrs/Budgeted Hrs.

= 10000/9000x100 = 111.11%

Efficiency Ratio

= Actual production in Standard Hour / Actual hours worked

= 10000/12480 x 100 = 80.13%

9. (a) ZMR LTD. in the business of Real Estate and Consumer Goods shows the following financial position for the year ending March31, 2019:

Particulars	Year ended 31st March	
	2019	2018
Liabilities		
Share Capital	33	33
Securities Premium Account	931	928
General Reserve	57	44
Capital Redemption Reserve	42	40
Profit & Loss Account	595	390
Long Term Borrowings	1013	670
Deferred Tax Liability	25	39
Short Term Borrowing	780	676
Trade Payable	715	747
Miscl. Provisions	79	73
Total:	4270	3640
Assets:		
Fixed Assets (Tangible)	647	614
Capital WIP	667	383
Non-Current Investments	2378	2048
Long Term Loans	53	66
Inventories	167	232
Trade Receivables	104	94
Cash and Bank Balance	107	69
Other Current Assets	25	30
Advance for Equipment	122	104
Total:	4270	3640

Profit before tax for the year 2018-19 was ₹326 crores (Previous year ₹397 Crores)

You are required to compute the following figures/ratios as stipulated in PART-D, PART-4 to Annexure of cost Audit Report under the Companies (Cost Records and Audit) Rules, 2014 for the year ended 31st March, 2019:

(i) Capital Employed

(ii) Net Worth

(iii) Debt Equity Ratio

(iv) PBT to Capital Employed

(v) PBT to NET Worth

(vi) Current Assets to Current Liabilities

(b) Gupta LTD., a manufacturing company provides the following extracts from its records for the year ended March 31, 2019.

The Company's specifications—Capacity for the machines per hour	2000 units
No of shifts (each shift of 8 hours) per day	3 shifts
Paid holidays in a year (365 days):	
(i) Sunday	52 days
(ii) Other holidays	13 days
Annual maintenance is done within these 13 holidays.	—
Preventive Weekly Maintenance for the Machines is carried on during Sundays. Normal idle capacity due to Lunch time, shift changes etc. per shift.	1 hour
Production based on sales expectancy in past 5 years (units in Lakh): 2017-18	125.85
2016-17	132.20
2015-16	126.46
2014-15	115.70
2013-14	122.45
Actual Production for the year ended March 31, 2019 (units in Lakh):	120.80

You are required to calculate:

(1) Installed Capacity

(2) Actual Capacity

(3) Normal Capacity

(4) Idle Capacity

(5) normal Idle Capacity-Keeping in view of the relevant Cost Accounting Standard (CAS-2).

Answer:

(a)

Year ended March 31			**2018**	**2019**	**2019**
(i) Capital Employed: Fixed assets (Tangible) Non-current investments			 614 2018	 647 2378	
Particulars	Previous Year 2018	Current Year 2019	2662	3025	
Current Assets : (A) Inventories Trade Receivables Cash & Bank Balance Other Current Assets Advance for Equipment	 232 94 69 30 104	 167 104 107 25 122			
(A)	529	525			
Current Liabilities : Short term borrowings Trade payables Misc. Provision	 676 747 73	 780 715 79			
(B)	1496	1574			
Working Capital (A – B) Capital Employed			(967) 1695	(1049) 1976	
Average capital employed for the year ended March 31, 2019 – **{(1695 + 1976) ÷ 2}**					1835.5

(ii)	Net Worth : (For the year ended Mar 31, 2019			
	Share capital		33	
	Securities premium a/c		931	
	General reserve		57	
	Capital redemption reserve		42	
	Profit and loss account		595	1658
(iii)	Debt (For the year ended March 31, 2019)			
	Long Term Borrowings		1013	
	Deferred Tax Liabilities		25	1038
	Debt Equity Ratio:	(1038 ÷ 1658)		62.6:100
		= 62.60%	Or	0.63:1
	Profit before tax March 31, 2019 (PBT) for the year			326
(iv)	PBT to Capital Employed:	(326 ÷ 1835.5)× 100		17.76%
(v)	PBT to Net Worth	(326 ÷ 1658)× 100		19.66%
(vi)	Current Assets to Current Liabilities: for 2019 (CA/CL) = (525/1574)		Or	0.333 0.33:1

(b)

1	Installed Capacity	365×8×3×2000=175.20 lakh units
2	Actual Capacity Utilization	[(120.80)÷175.20] × 100 = 68.95%
3	Normal Capacity	(125.85+132.20+126.46+ 115.70+122.45)/5 = 124.53 lakh unit = 71.07%
4	Idle Capacity	(175.20 – 120.80) = 54.40 lakh units (54.40)÷175.20 = 0.3105 i.e. 31.05%
5	Abnormal idle Capacity	(124.53–120.80) =3.73 lakh units i.e., or (3.73/175.20)=2.12%

***Note:** Normal capacity is the volume of production or services achieved or achievable on an average over a period under normal circumstances taking into account the reduction in capacity resulting from planned maintenance.

As the information regarding production is available for last 5 years, the same has been considered for calculation of Normal Capacity for more correct presentation.

10. The following is a summary of the Profit and Loss Account of M/s. Ericson Limited for the year ended 31.03.2019. There was a major breakdown of machinery resulting in loss of production for 42 days, in June and July, 2018 and a labour strike for 97 days from 14.2.2019 to 21.5.2019. The Company produced a single product (Steel-Billet) and the production during the year was 942000 kgs.

Sales		13,540
Cost of Sales: Raw Materials	5,600	
Stores and Spares	830	
Salaries and Wages	1,400	
Power and Fuel	470	
Major Breakdown Repair	35	
Repair & other regular maintenance	94	
Carriage Outwards	320	
Insurance General	34	
Insurance-Transit	22	
Advertisement and Sales Promotion	720	
Rent, Rates and Taxes	97	
Printing, Stationery etc.	437	
Travelling and Conveyance	776	
Other Administrative expenses	426	
Depreciation	391	
Interest	1,494	
		13,146
Profit		394

You are required to compute the amount of abnormal cost on account of the breakdown and strike and the impact on cost per unit of output. Where do these figures find a place in the Cost Audit Report?

Answer:

Period Costs incurred when there is no production are deemed as abnormal and the costs apportioned for such periods are excluded from cost of production of the product.

Particulars	in lakh
Salaries & Wages	1,400
General Insurance	34
Rent, rates & taxes	97
Other administrative expenses	426
Depreciation	391
Interest	1,494
Total Fixed Cost	**3,842**

Total period of production stoppage:

Due to machinery breakdown Due to strike 14.02.2019 to 31.03.2019	42days 46days
	88 days

Fixed Costs apportioned to the period of production stoppage

= ₹ 3842 lakhs x 88 / 365 Major breakdown repair	₹ 926.29lakhs ₹35.00lakhs
Total abnormal cost	₹ **961.29 lakhs**

The abnormal cost works out to approximately 9.88% of the total cost of production and should be excluded from the respective elements of cost in the cost sheets and should be stated in the Reconciliation Statement of Para 2, PART D of the Annexure to the Cost Audit Report.

The abnormal cost included in Cost of Production is ₹ 9,61,29,000/9,42,000

= ₹ 102.05 per Kg.

Working Note:

Cost of Production:

	in lakhs
Raw Materials, Stores and Spares	5,600
Salaries & Wages	1,400
Power & Fuel	470
Repair & other regular maintenance	94
Insurance General	34
Rent, Rates & Taxes	97
Printing & Stationery	437
Travelling & Conveyance	776
Other Admni. Exp.	426
Depreciation	391
Cost of Production	**9,725**

Abnormal cost = 961.29*100/9725 = 9.88%

Note:

- ✓ Carriage outward and insurance in transit are considered not forming part of cost of production.
- ✓ Advertisement and Sales Promotion and Interest are not forming part of Cost of Production.
- ✓ Major breakdown not considered as part of Cost of production. To be shown in reconciliation statement.

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