FINAL EXAMINATION

December 2023

P–19(CMAD)
Syllabus 2016

COST AND MANAGEMENT AUDIT

Time Allowed: 3 Hours

Full Marks: 100

The figures in the margin on the right side indicate full marks.

Both Sections are compulsory. Each section contains instructions regarding the number of questions to be answered within the section.

All working notes must form part of the answer.

Wherever necessary, candidates may make appropriate assumptions and clearly state them in answer.

Section-A (20 Marks)

(All parts of the questions to be answered)

1. **Choose the most appropriate answer from among the four alternatives given (1 mark is for the correct choice and 1 mark is for the justification/workings):** 2×10=20

(i) Alphabeta Ltd has a machine of productive capacity of 2,500 unit per hour. It runs 3 shift of 8 hours each, half an hour recess in between, weekly off on Sunday and 12 nos of statutory holidays per year. Maintenance and change of shift are done during running time. The Normal capacity of the unit per year as per Cost Accounting Standard 2 is in lakh units.

(A) 219.0000

(B) 205.3125

(C) 169.3125

(D) 180.6000

(ii) The Internal Audit function on Operational Audit area has the focus on_____.

(A) Transaction-based analysis for Fraud Prevention

(B) Compliance of Rules

(C) Risk Identification, Process Improvement

(D) Budget Monitoring

(iii) Identify one of the following costs appearing only in Cost Accounting Records:

(A) Dividend Equalization Fund, Sinking Fund etc.

(B) Interest on Mortgage, Loans

(C) Notional Interest on Capital

(D) Loss due to scrapping of Plant, Machinery.

(iv) Disclosure to transactions with Related Parties under Para D-5 of Annexure to the Cost Audit Report be made

(A) for each related party for the year as a whole.

(B) for each product/service for the year as a whole.

(C) combination of (A) and (B) above.

(D) combination of (A) and (B) transaction-wise.

(v) In which of the following Cost Accounting Standard, the 'Treatment of Revenue in Cost Statements', is dealt?

(A) Cost Accounting Standard 24

(B) Cost Accounting Standard 16

(C) Cost Accounting Standard 8

(D) Cost Accounting Standard 21

(vi) The Cost Centre which primarily provides auxiliary service across the entity is a

(A) Production Cost Centre

(B) Selling and Distribution Cost Centre

(C) Support Service Cost Centre

(D) Labour Cost Centre

(vii) Which Audit, gives a comprehensive picture of the status of effectiveness of corporate development and highlights developmental needs?

(A) Corporate Social Responsibility Audit

(B) Corporate Developmental Audit

(C) Propriety Audit

(D) Efficiency Audit

(viii) Which is a Dictionary of all cost elements required in the Cost Audit Report in context with XBRL?

(A) Costing Taxonomy

(B) Instance Document

(C) Schema

(D) Table

(ix) A manufacturing unit showed, during the Financial Year 2022-23, the following financial data (in ₹ lakh); Net Sales of 1,250, Export Incentives 85, Other Income 106, Adj. of Finished Stock (+) 95, Materials 634, Salaries 425, Overheads 101.8 and Tax 52.6. The Value Added as per Rules is (in ₹ lakh) _____.

(A) 946

(B) 796

(C) 755

(D) 688

(x) 'Sugar and Industrial Alcohol' belong to _____ sector for Application of Cost Records.

(A) regulated.

(B) non-Regulated.

(C) both depending on circumstances.

(D) None of the above.

Section-B (80 Marks)

Answer *any five* questions from question numbers 2 to 8.

Each question carries 16 marks.

2. (a) ABC was appointed as Cost Auditor of PQR Ltd for FY 2023-24. After three months of appointment, for some reasons, the Cost Auditor becomes disqualified to be appointed as Cost Auditor. State the steps to be taken by the Company as a consequence of such event. 8

(b) PQR Ltd., changed its stock valuation policy from Average Cost Method to First in First Out Method in the Financial Year 2022-23. As a result of which the profit of the Company was reduced by ₹ 10 lakhs. The change in the accounting policy and the fact of the loss were not disclosed by the company or by the Cost Auditor in the Audit Report. State whether the Cost Auditor is deemed to be guilty of professional misconduct. 8

3. (a) Answer the following with reference to Transportation Cost as per Cost Accounting Standard 5:

(i) What items of cost shall be included and not be included in Transportation Cost?

(ii) For apportionment of outward transportation cost, what basis should be adopted?

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(b) The profit as per Financial A/c of ABC Cement Ltd. for the year 2022-23 was ₹ 1,34,27,516. The profit as per Cost Accounting records showed a different figure. You are required to prepare a reconciliation statement and arrive at profit as per Cost Accounts. The following details were collected from Financial Accounting and Cost Accounting records.

Particulars	Financial A/c (₹)	Cost A/c (₹)
Opening WIP	29,52,315	23,45,720
Opening Finished Goods	2,48,37,410	2,72,16,930
	2,77,89,725	2,95,62,650
Closing WIP	41,72,635	36,35,345
Closing Finished Goods	3,67,51,410	4,15,24,148
Interest Income from Inter Corporate Deposits	6,14,250	-
Donations given	4,75,250	
Loss on Sale of Fixed Assets	1,04,148	-
Value of cement taken for own consumption	3,75,920	3,45,200
Cost of Power drawn from own windmill:		
At EB Tariff		48,58,415
At Cost	34,10,420	

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4. (a) What are the benefits of Management Audit? 8

(b) WXY Ltd., a car manufacturing company has its product segmentation of Medium Commercial vehicle, Medium Passenger Vehicle and Deluxe Passenger Vehicle. There is reported loss in Medium Passenger Vehicle for the last two years. Make a checklist for evaluation of performance to identify the weak areas and find remedies. 8

5. (a) As per Clause 3(iv) of CARO, 2015, the Auditor has to comment whether there is adequacy of Internal control. How the Auditor obtains an understanding of internal control system? 8

(b) Briefly discuss the Internal Audit program of Non-Government Organizations. 8

6. (a) The following is the abridged Balance Sheet of B Ltd., a single product manufacturing Company:

Particulars	as at 31.03.2023 (Amount in ₹ lakhs)	as at 31.03.2022 (Amount in ₹ lakhs)
LIABILITIES:		
Share Capital	700	700
Reserves and Surplus:		
Debenture Redemption Reserve	50	60
Capital Subsidy from State Government	70	70
Revaluation Reserve	250	290
General Reserve	310	260
Profit and Loss A/c	106	74
Secured Loans	570	600
Unsecured Loans	240	248
Total	2,296	2,302
ASSETS:		
Gross Block	1,550	1,460
Less: Accumulated Depreciation	(730)	(680)
Net Block	820	780
Capital Work-in-Progress	96	84
Investments	30	30
Current Assets, Loans and Advances:		
Inventories	843	892
Sundry Debtors	374	400
Advances for Equipment	58	44
Other Loans and Advances	298	284
Cash and Bank Balances	46	36
Current Liabilities and Provisions:		
Sundry Creditors for Capital Expenses	(34)	(42)
Sundry Creditors for others	(370)	(394)
Provision for Taxes	(138)	(142)
Miscellaneous Expenditure	273	330
Total	2,296	2,302

Additional Information available:

(i) Term Loans repayable in 12 months included under 'Secured Loans' are ₹ 202 lakhs (Previous Year ₹ 158 lakhs).

(ii) Profit before Tax for the year ended on March 31, 2023 is ₹ 170 lakhs (Previous Year ₹ 164 lakhs).

You are required to compute the following figures/ratios as stipulated in Cost Audit Report under Companies (Cost Records and Audit) Rules, 2014, for the year ended on March 31,2023:

(i) Average Capital Employed

(ii) Net Worth

(iii) Profit Before Tax to Capital Employed

(iv) Profit Before Tax to Net Worth 8

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

Blow room :	Cotton processed Laps produced	4674560 kgs. 4259970 kgs.
Carding :	Laps processed Silvers produced	4276360 kgs. 3978420 kgs.
Draw frames :	Silvers processed Silvers drawn	3950240 kgs. 3903810 kgs.
Roving (Simplex) :	Drawn silvers processed Transferred to Ring frame	3876120 kgs. 3833510 kgs.
Ring frame :	Silvers used Finished Yarn produced	3913640 kgs. 3643740 kgs.
Reeling and Winding :	Yarn wound Saleable Yarn produced	3637420 kgs. 3582890 kgs.

Calculate the process wise Waste Multiplier factors for the year ended on March 31,2023. 8

7. (a) MNC Ltd. has received an enquiry of 1,200 numbers of EFT Drone Frame to be supplied over a period of 1 year to State Government Agriculture Dept. The State Government has arranged a soft loan @ 6% p.a. for capital equipment and working capital need of the unit. Capacity exists for manufacture of the products, and the estimated unit manufacturing cost for lot of 100 units are given below. Estimate the price to be quoted

by the company if the profit expectations are 15% of sales value and the interest cost is 5% of before interest cost per unit.

	Particulars per unit	Lot 100
1.	Raw Material 6kg@ ₹ 5,000/kg	6kg
2.	Stores, spares, power	5,500
3.	Labor Hrs	2,000 hr
4.	Labor Rate	₹ 9/hr
5.	Factory Overhead	₹ 5/labor hour
6.	Selling & Forwarding expenses	₹ 5,000
7.	Interest as% on total cost	5%
8.	Net Return on sales price	15%

Prepare a Cost and Price Statement. 8

(b) A factory located in a northern state experienced a devastating cloud-burst which paralyzed all activities from 16.09.2022 to 14.11. 2022 in company of which you were the Cost Auditor for the year FY 22-23. Although the company began working from 15.11.2022, production could effectively begin only from 7.12.2022. The expenses incurred during the year ended 31.3.2023 of 305 days of working were:

Particulars	Expenses for the year as a whole	Expenses for the closure period
	₹ lakh	₹ lakh
Salaries & Wages Direct	1,035	
Salaries & Wages Indirect	690	245
Power (variable)	415	
Depreciation	620	205
Other Fixed Expenses	825	310
	3,585	755

Calculate the amount which should be treated as abnormal for exclusion from the product costs, ignoring loss of capital nature. 8

8. Answer any four out of the following five questions: 4×4=16

(a) Scope and objective of the Cost Accounting Standard -102.

(b) As the Internal Auditor, draw a specimen Internal Audit program for given assignment.

(c) What are the Functions of Management Audit?

(d) In a single shift of 8 hr (with 30 min recess)running factory for 26 days in a month, the capacity utilization ratio and capacity usage ratio are 90% and 84% respectively. The break up for idle time is like waiting for i) material and tools–4 hrs, ii) for job–5 hrs, iii) breakdown – 3 hrs. Calculate the cost of idle time, where the hourly fixed cost is ₹ 22.50 (average per machine).

(e) As a Cost Auditor of a manufacturing company, furnish any four relevant suggestions and observations regarding performance of the Company based on the following information: (You may make necessary assumptions):

Particulars	2023	2022
Profit (₹ in Lakhs)	250	340
Capacity Utilization	90%	95%
Consumption of Electricity / Tone of Output (KWH)	4.07	3.98
Capital Employed (₹ in Lakhs)	1,200	1,100
Salaries and Wages (₹ in Lakhs)	117	98
Production (MT)	1,80,000	1,90,000

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SUGGESTED ANSWERS

SECTION – A

1.

(i) (C)

(ii) (C)

(iii) (C)

(iv) (C)

(v) (A)

(vi) (C)

(vii) (B)

(viii) (A)

(ix) (B)

(x) (A)

SECTION – B

2. (a)

(i) In the present case, the Auditor has deemed to have vacated his office. For any casual vacancy of Cost Auditor shall be filled by the Board of Directors within 30 days of occurrence of such vacancy.

(ii)

(a) The fresh appointment has to follow the same procedure as for appointment of original Auditor, viz. (a) in the case of companies which are required to constitute an audit committee- (i) the Board shall appoint an individual, who is a cost accountant in practice, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee, which shall also recommend remuneration for such cost auditor;(ii) the remuneration recommended by the Audit Committee under (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;

(b) in the case of other companies which are not required to constitutean audit committee, the Board shall appoint cost auditor fixing the remuneration and the remuneration so fixed shall be ratified by shareholders.

(iii) The new Cost Auditor shall submit acceptance letter along with eligibility certificate after receiving the offer of appointment.

(iv) Within 30 days of Board meeting in which appointment is made, the Company shall file a Revised Notice to Central Government through electronic mode, in Form CRA -2 along with fees as per Rules.

2. (b)

The Part I of the Second Schedule to the Cost and Works Accountants Act,1959 stipulates that a cost accountant in practice shall be deemed to be guilty of professional misconduct, if he:

(i) Fails to disclose a material fact known to him in a cost or pricing statement, which is not disclosed in a cost or pricing statement, but disclosure of which is necessary in making such statement, where he is concerned with such statement in a professional capacity;

(ii) Does not exercise due diligence, or is grossly negligent in the conduct of his professional duties;

(iii) Fails to invite attention to any material departure from the generally accepted procedure of costing and pricing applicable to the circumstances;

In the given case, the Cost Auditor has not disclosed the fact of changing the accounting policy in the valuation of inventory and the resultant loss in the books of account for the year 2022-23. Hence, the Cost Auditor is deemed to be guilty of Professional Misconduct.

3. (a)

(i) The items to be included in computing Transportation Cost as per CAS 5 are:

- Variable Costs
  Salaries, Wages of Drivers, Cleaners, OthersFuels & Lubricants
  Consumables
  Amortized cost of Tyre, Tube, Battery, Spares
  Repairs and Maintenance
  Other Variable Costs
- Fixed Cost
  Insurance
  License, Permit FeeDepreciation
  Other Fixed Cost to be specified.
- Items not included in Transportation Costs
  Penalty
  Detention chargesDemurrage
  Break-down costs
  Abnormal and non-recurring expenses

(ii) The following basis may be used, in order of priority, for apportionment of outward transportation cost depending upon the nature of products, unit of measurement followed and type of transport used :

- Weight
- Volume of goods
- Ton - Km
- Unit / Equivalent unit
- Value of goods
- Percentage of usage of space

Once a basis of apportionment is adopted, the same should befollowed consistently.

3. (b)

Particulars	Current Year (₹)
Profit as per Financial Accounts	1,34,27,516
Interest Income from inter-corporate Deposits	(-)6,14,250
Loss on Sale of Fixed Asset	(+)1,04,148
Donations not considered in Cost Accounts	(+)4,75,250
Difference in value of cement taken for own consumption	(-)30,720
Difference in Stock Valuation	(+)24,62,523
Cost of Power Drawn from Windmill	
(Additional cost in Cost Accounts)	(-)14,47,995
Profit as per Cost Accounting Records:	1,43,76,472

4. (a)

Benefits of Management Audit:

- **(i)** It helps management in framing basic policies for the organisation and to define objectives.
- **(ii)** In pursuance of the objectives of the organizations, management audit helps in preparing a viable and achievable plan for the organization.
- **(iii)** It helps in setting up an organizational framework to implement the plans.
- **(iv)** It assists in designing systems and procedures for smooth operation of the organisation.
- **(v)** It helps in designing systems and reviewing management information system (MIS) for decision making to help in coordination, motivation and control of the operations.
- **(vi)** It assists in analysing SWOT (Strengths, Weaknesses, opportunities and threats) of the organisation and assists in marketing the organisation stronger.
- **(vii)** In a developing country like India, management audit through CAG, public accounts committee and parliamentary committee on public undertakings, has helped the Government in identifying improper or wasteful use of funds, checking extravagant organization practices and curving ineffective use of physical resources.
- **(viii)** Indian financial institutions, banks and Board for Industrial Finance and Reconstruction (BIFR) have found management audit useful in monitoring sick industrial units and to help the units in their rehabilitation.
- **(ix)** The Railways of India have subjected their finances to open discussion by public to improve resource mobilization, reduce cost of operations and conserve their scarce resources which are main objectives of management audit.
- **(x)** It can help in analysing social-cost benefit analyses for public projects like dams, power houses, national highways etc.
- **(xi)** It is essential whenever a unit is planned to be taken-over or an amalgamation or merger with other unit is proposed.
- **(xii)** Growing number of professional managers, the continuing separation of ownership from management, the wider distribution of stockholders, increasing competition and sickness in industry will sooner or later make certified management audit compulsory just as financial audit has become statutory.

4. (b)

Certain industries focus on segmentation of its products in limited markets and customer types, depending on its production capability and market behavior of the products. The management may choose to understand its position in the different markets and different customers it serves. The auditor should observe the segmentation method adopted by the company for analyzing its profitability.

The objective is to

- **(i)** take suitable action for the segments that are not performing as per desired targets by introducing campaigns or pull out of those segments that are no longer attractive.
- **(ii)** analyze the demand pattern based on geographical areas or customer profiles or other channels of distribution and to see, if there is any shift of preference.
- **(iii)** Variation of turnover vis a vis that of profitability be measured tolocate the exact area of operation which is lagging.
- **(iv)** A study of concentration risk viz. overdependence on a few customer or area may locate possible weaknesses.
- **(v)** The checklist will consist a) study of Market and customer-wise sales and cost reports b) The marketing campaigns undertaken by the company c) Date on new markets or new customers added during the year and d) market study to see if any variation has taken place in customer preference and product usage.

5. (a)

Internal Accounting control comprises of the plan of an organization andthe procedures and records that are concerned with the safeguarding of assets and the reliability of financial controls. Internal control, so far as financial and accounting aspects are concerned, aims at the following:

- **(i)** Providing the flow of work through various stages.
- **(ii)** There should be proper segregation of personnel duties so that no single person can be in a position to handle whole of the work from itsbeginning to its end.
- **(iii)** Adequate documentation should be made at each stage of work.
- **(iv)** The transactions are recorded with appropriate amounts and in timely manner and that too as per the applicable accounting policies and practices.
- **(v)** The assets should be properly safeguarded. The access to the assets should be restricted to only authorized persons.
- **(vi)** Existence of organizational chart would help in fixingresponsibilities.
- **(vii)** Building up of a system to locate the deviations and departuresfrom the prescribed procedures and to detect the frauds and errors automatically without mush loss of time.
- **(viii)** Standardized records and formats should be evolved. It would ensure availability of right information at right time.
- **(ix)** There should be an efficient Management InformationSystem.
- **(x)** Minimization of loss and wastages.
- **(xi)** Employees should be encouraged to do good work and comply with the procedures. Special attention should be given to the disgruntled employees.
- **(xii)** Adequate cut off procedures should be formulated so that the transactions of one period can be separated from the transactions of other period. The Auditor should obtain an understanding of the accounting system sufficient to identify and understand major classes of transactions, manner of initiation of transactions, significant accounting records, supporting documents and specific accounts in the financial statements and the accounting and financial reporting process.

5. (b)

While planning the audit of a Non-Governmental Organization (NGO), the auditor may concentrate on the following;

- **i.** Knowledge of the NGO‟s objective, mission, and vision, areas of operations, and environment in which it operates.
- **ii.** Reviewing the legal form of the organization and its Memorandum and Articles of Association, rules, and Regulations.
- **iii.** Reviewing the NGO‟s Organization chart, Financial and Administrative Manuals, Project and Program Guidelines, and Funding Agencies Requirements and Formats.
- **iv.** Examination of minutes of the Board/Managing Committee/Governing Body/Management and Committees thereof to ascertain the impact of any decisions on the financial records.
- **v.** Study the accounting system, procedures, and internal controls and verify their applicability.

The audit program should include in sequential order all assets, liabilities, income, and expenditures ensuring that no material is omitted, and details vouched and/ or checked particularly in the following heads:

- **a)** Corpus fund.
- **b)** Reserves.
- **c)** Ear-marked Funds.
- **d)** Project/Agency Balances.
- **e)** Loans.

f) Investments.
g) Cash in Hand.
h) Bank Balance.

6. (a)

(i)	Average Capital Employed =	₹ 1,414.50	(₹ in Lakh)
(ii)	Net Worth =	₹ 963	(₹ in Lakh)
(iii)	Profit Before Tax to Capital Employed =	12.02%	
(iv)	Profit Before Tax to Net Worth =	17.65%	

6. (b)

Process	Waste Multiplier
Total Consumption	1.3161
Blow Room	1.1994
Carding	1.1158
Draw Frames	1.1027
Roving(Simplex)	1.0906
Ring Frames	1.0153
Reeling and Winding	1.0000

7. (a)

Estimated Cost and Price Quotation

Carbon Fibre Drone Frame – Lot of 100 units	₹
Total cost	71,925
Sales price (profit 15% of sales)	84,618
(Estimated Profit- Balancing fig)	12,693

7. (b)

Abnormal fixed cost

Stoppage	Abnormal Fixed Cost ₹ lakh
Full stoppage 60 days	755
Partial stoppage 22 days	174
Exclude Fixed cost fortotal stop of 82 days	929

8. (a)

The objective of Cost Auditing Standard 102 is to provide guidance to prepare documentation that provides

(i) Sufficient and appropriate record of the basis of Cost Auditor's Report
(ii) Evidence that the audit was planned and performed in accordance with Cost auditing Standards and applicable legal & regulatory requirements

The Standard deals with the Cost Auditor's responsibility to prepare audit documentation for audit of cost statements, records and other related documents. The specific documentation requirements of other Cost auditing standards do not limit the application of this auditing standard. Laws and regulations may establish requirements of additional documents.

8. (b)

An audit program, also called an audit plan, is an action plan that documents what procedures an auditor will follow to validate that an organization is in conformance with compliance regulations. It is a written plan containing exact details with regard to the conduct of Internal Audit like others. It is a description of thework to be done during an audit. A specimen of an audit program isgiven below:

ABC Ltd Audit program of Internal Audit Wing

Internal Audit Staff Involved:	Mr. A- Internal Auditor, H.O.D Mr. B, / Mr. C, / Mr. D, etc.		
Particulars	Remarks	Time Taken	Signature
Management Confirmation			
Cash Book			
Bank statements			
Bank Reconciliation			
Purchase Book			
Various other Ledgers …			
Compliance of various laws on Return submission etc.			
Safeguarding assets			
Defaults leading to loss			
Any other as deemed fit.			

8. (c)

Functions of Management Audit

The functions of management audit extend to audit of the effective functioning of every area of operations coming under the management purview from the stage of its planning to proper implementation and execution. Every manufacturing or service organisation could broadly be identified into the following functional areas –

- **(i)** Marketing, including selling and distribution.
- **(ii)** Manufacturing/servicing, including maintenance of supply chain, machinery and equipment, etc.
- **(iii)** Human resource management from selection to recruitment, training, motivating, retaining, advancement, etc.
- **(iv)** Personnel policies and industrial relations.
- **(v)** Finance including maintenance of accounts and providing accounting information to guide the management of its performance and position.
- **(vi)** Research & development including application research and basic research, if any.

An understanding of the objectives of each functional area at every level of the organisation and effectively achieving such objectives shall be the prime responsibility of management. Checking of such effective achievement is the function of management audit.

8. (d)

The cost of idle time = ₹ 1,071

8. (e)

Cost Auditor's Observations and Conclusions:

The profit of the company has declined by ₹ 90 lakhs during the year 2023, as compared to the year 2022.

This may be due to the following reasons:

- **i.** Production during the year 2023 has decreased by 10,000 MT. This is perhaps due to the underutilization of capacity from 95% to 90%. It may also be due to a scarce power supply.
- **ii.** Based on further analysis and scrutiny, it is noted that the cost of production/ Tone has increased (Assumption).
- **iii.** It has also come to light that the price of the product in the market has declined. This may be due to stiff competition. (Assumption).
- **iv.** Profit as a % of Capital Employed has declined from the figure of 30.9% in 2022 to 20.8% in year 2023. This is partly due to a decline in the amount of profit and partly due to an increase in capital employed.
- **v.** The consumption of electricity in terms of kwh/ Tone of output has increased from 3.98 in 2022 to 4.07 in 2023. This is a serious matter which needs investigation and necessary action is to be initiated.
- **vi.** There is an increase in Salaries and Wages by ₹ 19 lakhs. This is due to the following reasons:

  - **a)** Increase in ₹ 7 lakhs due to increments and promotions (Assumptions).
  - **b)** Increase in ₹ 3 lakhs due to additional DA paid to the workers (Assumptions).
  - **c)** Remaining ₹ 9 lakhs is due to the employment of new workers (Assumptions).

Engagement of these new workers is not justified on economic considerations and this has resulted in excessive idle time. Additional work needs to be created for these workers.